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LETTER FROM THE EDITOR

Welcome to the third issue of the *Academy of Strategic and Organizational Leadership Journal*. The Academy of Strategic and Organizational Leadership is an affiliate of the Allied Academies, Inc., a non profit association of scholars whose purpose is to encourage and support the advancement and exchange of knowledge, understanding and teaching throughout the world. The *ASOLJ* is a principal vehicle for achieving the objectives of the organization. The editorial mission of this journal is to publish empirical and theoretical manuscripts which advance the discipline, and applied, educational and pedagogic papers of practical value to practitioners and educators. We look forward to a long and successful career in publishing articles which will be of value to many scholars around the world.

The articles contained in this volume have been double blind refereed. The acceptance rate for manuscripts in this issue, 25%, conforms to our editorial policies.

We intend to foster a supportive, mentoring effort on the part of the referees which will result in encouraging and supporting writers. We welcome different viewpoints because in differences we find learning; in differences we develop understanding; in differences we gain knowledge and in differences we develop the discipline into a more comprehensive, less esoteric, and dynamic metier.

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A CEO-ISSUES MODEL OF FIRM PERFORMANCE FOR SINGLE-BUSINESS MANUFACTURERS

Bruce A. Walters, Oklahoma City University
Richard L. Priem, The University of Texas at Arlington

ABSTRACT

This field study examines the performance implications of CEO succession plans and compensation perceptions in a sample of single-business manufacturing firms. Zajac (1990) tested these relationships in his "CEO-issues model of firm performance" using a sample of the largest U.S. corporations. Our study replicates Zajac's (1990) earlier work, but uses a sample of CEOs who head smaller, single-business manufacturing firms. Our results indicate that smaller-firm CEOs who perceive a connection between their firm's wealth and their own reputation are associated with higher-performing firms.

INTRODUCTION

Interest in chief executive officers (CEOs) and their effects on firm performance has led to research that evaluates CEOs from multiple perspectives. The organization literature, for example, has focused on personal characteristics (e.g., Hambrick & Mason, 1984). Literature in industrial organization economics has focused on agency relationships (e.g., Jensen & Meckling, 1976). Zajac (1990) combined the organizational and agency perspectives in developing and testing his "CEO- issues model of firm performance" (1990: 223). With a sample of the largest U.S. corporations, he found that higher-performing firms: promoted CEOs from within; had CEOs with specific successors in mind; and had CEOs who perceived a greater connection between their personal wealth and the wealth of the firm. He obtained no support, however, for the propositions that higher-performing firms had CEOs who were more satisfied with their compensation and who perceived greater connection between their personal reputation and the wealth of their firm.

Our study replicates and extends Zajac's (1990) work by examining similar issues for smaller, single-business firms. We argue that the relationships of CEO issues to firm performance may be altered when they are examined in differing contexts. Contingency theory has shown that theory development may benefit from examining phenomena under varying conditions (e.g., Tosi & Slocum, 1984). We concur with Hubbard, Vetter, and Little (1998), in that replication and extension research is necessary for the development of a cumulative body of knowledge. The influence of the CEO on firm-specific outcomes, and the influence of contextual factors on CEO behavior, may depend in part on the levels of other variables

(Rosenberg, 1968). One such variable, organizational size, may be a key influence on both the strength and the form of relationships between CEO issues and firm performance.

Our objective is to explain more fully how CEO succession plans and compensation issues can affect firm performance. Specifically, we extend Zajac's theory to smaller, single-business firms, arguing that organizational size may be an important contingency factor, due in part to its well-accepted relationships with other structural, environmental and process variables. In the sections that follow, we first argue that organization size may set boundary conditions for Zajac's theory. We then describe a field study testing this argument, and discuss the implications of our results.

THEORY DEVELOPMENT AND HYPOTHESES

Zajac (1990) found strong support for the hypothesis that firms whose CEOs were promoted from within are better performers than firms with externally-obtained CEOs. The logic supporting his hypothesis stemmed from principal-agent theory (Ross, 1973; Jensen & Meckling, 1976). The theory states that "agency" problems can occur in situations where a principal hires an agent to function on behalf of the principal, and three other conditions are present. The first of these conditions is that the individual goals of the agent are not congruent with those of the principal. The second is that the agent possesses more information about the tasks involved and his/her abilities than does the principal. The third condition is that the quality of task performance is hard to measure.

One common situation in which agency problems may arise is that of a CEO acting as agent for a corporation's stockholders (i.e., the principals). The CEO often controls many resources while holding little ownership interest in the firm. This provides some incentive to overspend corporate resources in ways that provide personal benefits to the CEO (e.g., a large staff, luxurious offices). If this goal incongruence is acted upon, the stockholders bear the cost while the CEO receives the benefit (Jensen & Meckling, 1976). Further, the CEO typically has more personal knowledge of the job and of his/her abilities, and holds more company-specific information, than do the shareholders (Baiman, 1982; Chakravarthy & Zajac, 1984). With this information asymmetry, shareholders have difficulty judging the quality of the CEO and the appropriateness of the CEO's resource allocation decisions. Finally, firm performance is influenced by a host of factors outside the CEO's control (Lieberson & O'Connor, 1972). Thus, it is hard for shareholders unambiguously to attribute variations in firm performance to the actions of the CEO.

Zajac argued that information asymmetry should be less severe when the Board of Directors selects an insider CEO, because the Board can know better the candidate's abilities and personal characteristics. Thus, there is less threat of selecting a CEO who is ultimately revealed to be less able than initially assumed. Further, the Board's foreknowledge makes it less likely that the internally-selected CEO will be able to undertake and effectively conceal actions inconsistent with shareholder interests.

Organizational size, however, may attenuate the relationship Zajac (1990) found in his sample of the largest U.S. corporations. Although Zajac controlled for size within the restricted range of his sample, his findings may not be generalizable to smaller organizations. For example, as found by the Aston studies (e.g., Pugh, Hickson, Hinings, & Turner, 1968; Inkson, Pugh, & Hickson, 1970), and later reinforced by others (e.g., Miller, 1987; Mintzberg, Raisinghani, & Theoret, 1976), large organizations such as those in Zajac's (1990) study are often more formalized and specialized than are smaller ones. Formalization refers to the use of formal procedures, job descriptions, cost and quality controls, specialists, and professional technocrats (Pugh et al., 1968; Miller, 1987). Specialization refers to division of labor in an organization, and the distribution of official duties among a number of positions (Inkson et al., 1970). These conditions are typically associated with rationality in strategy making, wherein specialists provide expertise conducive to rational decision processes (Mintzberg et al., 1976). Career paths within large corporations typically involve rotation through a variety of managerial positions. Such firms are also likely to have extensive management development programs. Large firms are more decentralized (Pugh et al., 1968; Inkson et al., 1970), resulting in more decision makers and the attendant need for bargaining, negotiation, and consensus-building. Such firms also exhibit broader product-market scope than do smaller firms (Chandler, 1962), allowing for more variety in the experiences of their managers. These factors - formalization, specialization, career progression, development programs, decentralization and variety of experience - combine to produce a training and selection ground for potential CEOs. Finally, size in itself simply results in more internal managers from which to choose during a CEO search. Thus, large corporations are likely to have a sufficient number of qualified internal CEO candidates from which to select.

Smaller organizations, on the other hand, likely have fewer internal managers who may be qualified for the CEO position. The actual number of managers available, CEO-qualified or not, is typically much smaller than for large corporations. This problem may be aggravated because small firms often acquire new managerial talent only when absolutely necessary to deal with the next phase of their growth (Greiner, 1972). Further, the managers who are available may have less access to development programs, and fewer opportunities for career progression or to gain varied experiences. Small firms may not have even a single viable inside successor, and the company may be *forced* to look to the outside. Thus, smaller firms have a smaller pool from which to select insider CEOs than do larger firms.

Further, agency issues resulting from information asymmetries may be less salient for smaller firms. Many small firms are privately owned, with concentrated ownership. When ownership is closely held, the relevant stakeholders likely possess more knowledge of the firm and are better evaluators of the CEO's effectiveness. They also have more leverage on the CEO's actions. Thus, the information asymmetries inherent in the largest publicly-held organizations are abated in smaller firms, and decision makers must focus primarily on the good of the organization. In addition, the choice of an outsider for a small firm might actually signal new strategic opportunities and a changed focus. Reinganum (1985), for example, found positive performance effects for external successors in smaller firms, but no significant succession effects among large firms. This may reflect the CEO's perceived constraints in larger firms, versus potential personal impact in smaller firms.

The foregoing discussion suggests that the relationship between CEO insider/outsider succession and firm performance may be different in smaller, single-business firms than in the largest U.S. corporations due to smaller firms': lack of potential inside successors; reduced information asymmetries; and greater personal influence of the CEO. First, there are fewer qualified inside successors in smaller firms, suggesting that the performance of smaller firms with insider CEOs may be substandard. Second, smaller firms with outsider CEOs are less likely to suffer performance declines due to the agency problems that are more salient for large firms. Finally, outsider CEOs may have more immediate influence on the performance of smaller firms. Thus, we argue that, for smaller firms, the relationship of insider/outsider succession will be the opposite of that found by Zajac for the largest U.S. industrial firms:

Hypothesis 1: In smaller firms, performance will be positively related to outside CEO appointments.

Zajac's (1990) study also found that firms whose CEOs have a specific successor in mind are higher-performing firms. His argument was that "an incumbent CEO's having a specific successor in mind represents a strong positive signal about the firm's top management" (Zajac, 1990: 220). Reasons he cited were that identification of a successor indicates the presence of highly qualified management talent below the CEO level (hence inside), and that the CEO is active in top management development.

The largest U.S. corporations can likely plan far enough ahead and have sufficient managerial talent that their CEOs have successors in mind as a natural course of action. Also, the CEO is likely to be highly involved in management development in the higher-performing firms. In high-performing smaller firms, on the other hand, the CEO may not have a specific successor in mind. The CEO's intense involvement in the day-to-day affairs of the firm may preclude the planning required for choosing a viable successor. Managers such as these, who are heavily burdened with a variety of decisions, may be more likely to operate using heuristics; they frequently refer to previous experience to develop shorthand assessments for immediate problems (Mintzberg, Raisinghani, & Theoret, 1976). Thus, they are less likely to engage in formal planning, including planning for succession.

In addition, the CEO and the firm's constituencies may simply not care if a successor is chosen at this point, because the choice of a successor may be perceived as less important in smaller companies. Even if highly successful, these firms may have grown from the inspirations of a single individual. Fewer possible internal successors are likely available and, at this stage in the firm's development, the leader likely has a stronger and more immediate personal impact than top managers might have in the largest corporations (Finkelstein & Hambrick, 1996; Miller, Droge, & Toulouse, 1988). Given the leader's strong personal influence, formal search for a possible successor may actually demotivate key employees and negatively affect firm performance. Such a search could also be the *result* of poor performance. Thus,

Hypothesis 2: In smaller firms, having a specific successor in mind will be negatively associated with firm performance.

Zajac (1990) argued that firms whose CEOs are more satisfied with their compensation would be high performers. This hypothesis, however, was *not* supported in his study. The logic of the hypothesis rests on the notion that CEO compensation can be used as a motivational tool to enhance firm performance. Thus, the expectation was that performance would be enhanced to the degree that the CEO is satisfied with compensation. We argue that this relationship is more likely in smaller firms, rather than the largest U.S. corporations.

In larger corporations, managerial perquisites that may not be included in the traditional definition of compensation may significantly affect satisfaction. For example, the large, well-established corporation traditionally represents security and status. The CEO may derive benefits from his/her association with the firm far beyond those offered through the compensation package. Additional examples include political ties, enhanced reputation in the business community, opportunities for speaking engagements, and increased job security. Moreover, potential involvement in interlocks (i.e., serving on the boards of other corporations), a common occurrence in the largest U.S. firms (Pennings, 1980), may further enhance a CEO's reputation and future opportunities. Thus, the compensation package alone may fail to account for other benefits available to the CEOs of large companies.

In smaller firms, however, these perks are typically less available. Compensation is likely more salient, and the CEO may be more likely to pursue satisfaction through compensation. Moreover, if the CEO of the small firm is not satisfied, he/she may seek other opportunities elsewhere. If this leads to higher CEO turnover, performance may suffer, producing a positive relationship between CEO satisfaction with compensation and firm performance. In addition, the agency relationship inherent in the largest corporations, where ownership is widely dispersed, is not nearly as relevant in smaller companies. Finally, as suggested by Miller et al. (1988), the CEO of a smaller firm may have much more personal impact on firm outcomes than the CEO of a large corporation. Thus, he or she would likely perceive that personal actions taken for the good of the organization should be appropriately rewarded in a timely manner. Therefore, we suggest:

Hypothesis 3: For smaller firms, those whose CEOs are more satisfied with their overall personal compensation will be higher-performing firms.

In Zajac's (1990) study, firms whose CEOs perceived greater connection between their personal wealth and the wealth of the firm were found to be higher performers. This finding is consistent with the agency theory viewpoint that the role of compensation structure (i.e., salary versus incentives) is to tighten the connection between the interests of the shareholders and those of the CEO. Performance-based incentives (e.g., long-term stock options) are seen as necessary to align the CEO's objectives with those of the widely-dispersed shareholders, thereby ensuring that the CEO will pursue actions beneficial to shareholders (Jensen & Meckling, 1976); otherwise, the costs associated with monitoring CEO behavior could be excessive.

Smaller firms, on the other hand, are more closely-held. Ownership is less dispersed. Often there are no shareholders; even if there are, they are more likely to have substantial voting blocks that attenuate the CEOs' power. With agency costs thus held to a minimum, CEO incentives primarily derive from personal gain: either in connection with sole/major ownership, or from rewards provided by knowledgeable stakeholders in the case of public ownership. Thus, nearly *all* CEOs of smaller firms could be expected to see a strong relationship between firm wealth and their personal wealth. Due to this restriction in range, we suggest:

Hypothesis 4: In smaller firms, CEOs' perception of a connection between personal wealth and firm wealth will not be related to firm performance, because nearly all CEOs will see this connection.

Zajac's (1990) results did not support the idea that firms whose CEOs perceive greater connection between their personal reputation as CEOs and the wealth of the firm would be higher-performing firms. With this hypothesis, Zajac attempted to test the notion that there exists an efficient managerial labor market (Fama, 1980) that helps minimize agency problems. Fama (1980) argued that the market for managerial labor is relatively efficient because reputation effects communicate managers' abilities, even if their previous performance cannot be evaluated unambiguously. Thus, CEOs' interests will be aligned with those of shareholders because CEOs are interested in maintaining a good reputation which will, in turn, maximize personal marketability.

The lack of support for the efficient managerial labor market in Zajac's (1990) study may follow from earlier arguments concerning CEOs' perceived impact in the largest corporations. As Finkelstein and Hambrick (1996) note, the CEO's personal impact is attenuated because of inertial forces (e.g., organizational size, age, a strong culture, and capital intensity) that limit his or her control. "Large, mature organizations with very entrenched cultures, such as IBM, Philips, Sears, and GE, are not easily changed. Their top executives operate under severe inertial constraints" (Finkelstein & Hambrick, 1996: 31). In very large corporations, systems and processes become well-entrenched. Structure may be rather hierarchical, with numerous staff experts and liaison devices (Miller, 1987). Also, potential scapegoats are more plentiful when firm performance is less than expected. Because a CEO may have limited perceived impact in the largest corporations, his/her reputation may be more insulated from performance results than would be the case in smaller firms.

Top managers of smaller firms likely have a more direct impact on firm outcomes (Miller et al., 1988). With more parameters potentially under the CEO's control, his or her personal reputation may be perceived as being more highly affected by organizational outcomes. Contrary to Zajac's findings for the largest corporations, Fama's (1980) efficient managerial labor market may actually be more effective in smaller firms. This arises, however, not because of agency theory's emphasis on shareholders' interests, but because of the CEO's perceived discretion, power, and responsibility for managing factors under his or her control. Thus, within smaller firms, those whose CEOs perceive greater connection between their personal reputation as CEOs and the wealth of the firm are likely to be higher-performing firms. This suggests:

Hypothesis 5: In smaller firms, the perceived connection between CEO reputation and firm wealth is positively related to firm performance.

METHOD

Sample and Procedures

This research used a multiple respondent, survey approach. Included are single-business firms that are much smaller in size and scope than those used by Zajac (1990), allowing us to Zajac’s hypotheses and make reasonable comparisons between the two types of samples. The desire was that each firm have multiple executives who are involved in strategy making and who are aware of the firm's performance relative to other firms in its industry, so a minimum size of 100 production workers was chosen. The firms were also autonomous and non-diversified. The autonomy criterion ensured that each CEO was unlikely to feel that firm performance was influenced by actions taken by a parent firm. The non-diversified criterion ensured that respondents were not attending to the differing environments which may be faced by different divisions in a diversified firm. We believe the firms in our sample met our objectives. The mean size (227, s.d.=158) and single-business nature of the firms provided a sample which allowed the testing of Zajac’s hypotheses, while ensuring clear differences between these firms and the largest U.S. corporations.

The CEO of each firm was asked by letter to identify the other member of the top management team who most regularly participates in the firm's strategic decision making process. This individual and the CEO were then each asked to complete a questionnaire intended to identify executive perceptions of their firm's performance relative to that of other firms in their industry. The use of the two executives limited common method variance and allowed interrater reliability analyses for the perceptual data. Six months after the initial questionnaire was completed, the CEO was asked to complete a background questionnaire and the succession-wealth scale from Zajac (1990).

One hundred and ten autonomous, non-diversified manufacturing firms, out of 309 firms selected from a southwestern state's *Survey of Manufacturers*, responded to the initial mailing. Forty-one CEOs completed the succession-wealth scale six months later. Their titles were all either CEO, President, or President and CEO, and in each case these individuals were the top executive in their firm. No reliable relationships were found between response/non-response and either annual sales or number of employees categorical variables (X^2=4.31, p=.23, n=257, and X^2=1.64, p=.65, n=309, respectively).

The mean size of the firms studied was 227 employees (s.d.= 158). Several firms in the sample reported fewer than 100 employees due to recent downsizing. The firms manufacture a variety of products, including fiberglass boats, oil field equipment, frozen vegetables and personal computers. No more than two firms participated in any one 4-digit SIC industry. The average CEO studied had spent 7.8 years (s.d.= 7.7) as the top executive of the firm and was 46.6 years old (s.d.= 10.3) at the time of the interview. The average CEO had been with the firm for 12.6 years (s.d.= 10.4), and had spent 18.3 years (s.d.=11.2) in the industry.

Measures

Succession and Compensation. Questions used for the succession and compensation-related issues were from Zajac (1990). The insider/outsider distinction and whether or not the CEO had a successor in mind were measured with dichotomous yes/no responses. Compensation satisfaction and perceived connections to personal wealth and reputation were measured by single items on a seven point scale.

Firm Performance. The CEO and the non-CEO respondent were also asked firm performance questions based on Dess and Robinson (1984). Respondents were asked to quintile-rank their firms' performance compared to other similar firms on after tax return on sales and after tax return on total assets, each for the previous five-year period. The comparison to other similar firms provides a form of control for differences in performance that may be due to industry (Dess, Ireland & Hitt, 1990) and strategic group (Hatten, Schendel & Cooper, 1978) effects. Subjective, self-reported performance measures were used in this study because most firms in the sample are closely-held, and their executives were expected to be reluctant to release more objective financial data. Subjective, self-reports such as these, however, have been found to be highly correlated with objective measures of firm performance (Dess & Robinson, 1984; Venkatraman & Ramunajam, 1987).

RESULTS

Descriptive Analyses

Means, standard deviations and correlations for the firm-level data gathered from the top strategy-making executives and the CEO data are presented below. Univariate analyses indicated that the size variable departs significantly from normality (Shapiro-Wilk W=.49, p<.001). Thus, this variable was transformed using the natural logarithm and is called Log Size (W=.95, p=.08).

TABLE 1: DESCRIPTIVE STATISTICS AND PEARSON CORRELATIONS									
(N=41)	Mean	SD	1	2	3	4	5	6	7
1) Log size		5.20	.69						
2) Insider/outsider CEO	1.6	.50	-.12						
3) Specific successor in mind	1.4	.50	-.32	-.10					
4) CEO satisfaction with total compensation	5.3	1.29	.21	.34	-.17				
5) Perceived connection between personal financial wealth and firm wealth	3.3	1.86	.04	.34	.03	.41			
6) Perceived connection between personal reputation as CEO and firm wealth	5.3	1.32	.18	-.11	-.01	.30	.11		
7) Return		3.20	.89	.44	.08	-.34	.23	.17	.36
Correlations of .24 are significant at p<.10, .30 at p<.05, and .38 at p<.01.									

Hypothesis Tests

The return on assets and return on sales variables were highly correlated (r=.90); they were therefore combined into a variable called "Return" for the subsequent regression analysis. Even though the range of organizational size is restricted in our sample, we also controlled for Log Size in the regression analysis (Blau & Schoenherr, 1971; Lindsay & Rue, 1980; Pugh, Hickson, Hinings & Turner, 1968). To test our hypotheses, Return was regressed on Log Size and on the independent variables together. Results are presented in Table 2.

TABLE 2: RESULTS OF MULTIPLE REGRESSION ANALYSIS RETURN			
(N=41) Independent variables	Unstandardized coefficients (standard errors)		Standardized coefficients
Log size	0.40	(0.20)	0.31*
Insider/outsider CEO	0.20	(0.30)	0.11
Specific successor in mind	-0.42	(0.27)	-0.24
CEO satisfaction with compensation	-0.04	(0.12)	-0.06
Perceived connection between personal financial wealth and firm wealth	0.06	(0.07)	0.12
Perceived connection between personal			

reputation as CEO and firm wealth	0.21	(0.10)	0.31**
*p<.10; **p<.05. Adjusted R^2=.23 (N=41); F=2.96; P=p<.05.			

Although the overall regression equation is significant and explains over 20% of the variance in Return, the individual hypotheses concerning insider/outsider succession and CEO satisfaction with compensation receive no support from this sample. Consistent with Hypothesis 5, however, we do find that CEO perception of a connection between personal reputation and firm wealth is associated with high performance. Also, Hypothesis 2, concerning successor identification, receives some weak support. Our results are counter to Zajac's (1990), as hypothesized, although they only approach significance (p=.13). Our supposition in Hypothesis 4 that, unlike for Zajac's (1990) sample, we would *not* find a relationship between CEOs' perception of a connection between personal and firm wealth and firm performance, was supported. Although this non-finding is a weak test, a true replication required that we test all of Zajac's hypotheses; our arguments led us to propose an insignificant relationship in this case.

DISCUSSION AND IMPLICATIONS

The model incorporating CEO succession and compensation factors explained 20% of the variance in firm performance in our smaller-firm sample. Our individual hypotheses, however, received mixed support. One of our arguments was that Fama's (1980) efficient managerial labor market would be more likely to operate in the smaller-firm arena, because managerial influence could be expected to be greater than for large firms, and scapegoats fewer. Thus, performance-associated reputation effects would be greater for smaller-firm CEOs than for CEOs of the largest U.S. corporations, and smaller-firm CEOs who perceive these effects would be associated with higher-performing firms. We indeed found that the CEOs in our smaller-firm, single-business sample who perceived a connection between CEO reputation and firm wealth were associated with higher-performing firms. Further, this hypothesis in Zajac's (1990) large-firm study did *not* receive support. These results together suggest strongly that CEO reputational effects are more salient for smaller, rather than larger, firms.

We argued further that, for smaller firms, having a successor in mind is *not* a signal of effective top management. Rather, because the existing CEO is such an influential player who is intensely involved in the firm's day-to-day operations, and because there are few qualified inside successors, in smaller firms having a successor in mind is likely associated with poor performance. Zajac's (1990) large-firm study found that CEOs who had a specific successor in mind were associated with higher-performing firms. We found some support for our counter-hypothesis, however, showing that firm size may moderate important CEO-performance relationships.

We also argued that, unlike for Zajac's (1990) sample, we would *not* find a relationship between CEOs' perceptions of a connection between personal and firm wealth, and firm performance. Within our smaller-firm sample we expected little variation in CEOs' perceptions; they would *all* see a strong connection between the wealth of the firm and their personal rewards, and this argument was supported.

Our two other hypotheses were not supported by our data. It may be that the issues of the insider-outsider distinction and CEO satisfaction with compensation are not as salient for smaller firms as they may be for larger firms. It may also be that our tests were not powerful enough to detect these relationships even though they do exist. With our sample size, the power to detect moderate relationships (f^2 =.15) is 0.80, but the power to detect small relationships (f^2 =.10) is much less (Cohen, 1988). This is a limitation of our study, although it also indicates that the relationships we did find are likely relatively strong.

Our study has a number of other limitations. First, because the sample is limited to manufacturing firms, the results may not be generalizable to CEOs of service firms. Second, the cross-sectional nature of our data suggests that the results must be viewed as tentative, particularly regarding causality. Although we have argued that CEO perceptions may influence the performance of their firms, it may also be the case that firm performance influences CEO perceptions. For example, poor performance could lead to a CEO's having a specific successor in mind. Third, we included only smaller, single-business firms in this study; both smaller and larger firms must be included in future research to examine more fully the moderating effects of organizational size on CEO selection/compensation-performance relationships.

Our research clearly confirms, however, that identification of the contexts within which proposed relationships hold is an important facet of theory building and testing. On-going tests designed to identify the boundaries of proposed relationships, through replication and extension of previous work, are necessary to specify and confirm any theory. Our smaller-firm study found several relationships that differ in form or strength from those identified by Zajac (1990) in his large-firm research. Thus, organizational size appears to be an important contingency factor affecting relationships between CEO succession or compensation factors and firm performance. Future research may examine other potential boundaries to the theory. One of these could be the degree to which it holds for smaller service, as well as manufacturing, firms. Further, the boundaries of many *other* organization theories may also be clarified via future research pursuing similar replications and extensions.

Our research also has important implications for boards of directors and top managers of all except the very largest manufacturing firms. First, our results suggest that CEOs of smaller manufacturing firms likely perceive a close link between their firm's wealth and their personal wealth; executive compensation plans should reinforce this link. Second, having a specific plan in mind for CEO succession may be associated with lower, rather than higher, performance. It may be that CEO succession simply is not one of the most critical day-to-day issues that must be attended to in such firms. Finally, it may be important to ensure that CEOs perceive links between firm performance and their professional reputation. Efforts to strengthen reputation-performance links (by, for example, encouraging CEO public visibility in the role of firm spokesperson) may pay off in improved performance.

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HUMAN RESOURCE MANAGER DISCRETION: THE INFLUENCE OF INSTITUTIONAL FACTORS

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ABSTRACT

An essential element of the strategic human resource management (SHRM) perspective is the range of decision making discretion a human resource manager has for enacting change in response to environmental contingencies. Higher levels of discretion lead to human resource practices that are more innovative, responsive to employees, and congruent with the business strategy of the organization. In this study, we examined the degree to which human resource manager discretion is influenced by an organization's institutional environment. More specifically, research suggests that institutional factors such as laws, regulations, and the expectations of external constituents may constrain human resource manager discretion, ultimately affecting the range and content of human resource practices. The results of this study indicate that institutional factors such as industry-type, legal coercion, environmental uncertainty, and the interconnectedness of the institutional environment and the organization influence human resource manager discretion. The implications of these findings are discussed.

INTRODUCTION

Strategic human resource management (SHRM) has been defined as the pattern of planned human resource deployments and activities intended to enable an organization to achieve its goals (Wright & McMahan, 1992). Within this perspective, human resource effectiveness is seen as flowing from strategic intent, whereby managers align human resource structure and content with environmental pressures and the business strategy of the firm (Dyer, 1985; Fombrun, Tichy, & Devanna, 1984; Lengnick-Hall & Lengnick-Hall, 1988; Schuler & Jackson, 1987a, b). An essential element of the SHRM perspective is the range of decision-making discretion a human resource manager has for enacting change in response to environmental contingencies. More specifically, discretion is likely to enable human resource managers to create more effective human resource systems. Recent research has found that companies where human resource managers have a wide range of decision-making responsibility and authority are much more likely to invest heavily in innovative work redesign, employee involvement, and total quality management programs (Mirvis, 1997). These companies are also more likely to help employees balance their work and family concerns and to have programs committed to valuing diversity (Mirvis, 1997).

The purpose of this study is to examine the degree to which human resource manager discretion is influenced by an organization's institutional environment. Institutional factors include laws and regulations, as well as the content of everyday interactions between members of the human resource profession. A central assertion of the institutional perspective is that organizations in institutional environments are pressured to become similar (Meyer & Rowan, 1977), or isomorphic, whereby organizations conform to the accepted norms of the population (DiMaggio & Powell, 1983; Rowan, 1982). Thus, institutional pressures likely affect the human resource manager's range of decision-making latitude, ultimately affecting human resource practices (e.g., Oliver, 1991).

HYPOTHESES

There are a variety of institutional antecedents which influence the level of discretion available to human resource managers (Oliver, 1991). Specifically, institutional pressures have been defined in terms of four factors: constituents, content, control, and context (Oliver, 1991). An organization's institutional constituents include the state, professions, interest groups, and the general public (Oliver, 1991). Each of these constituents impose a variety of laws, regulations, and expectations on the organization, acting independently and in concert to limit discretion. Similarly, human resource management departments or units interact with a variety of constituencies, many of which are in the firm's external environment (e.g., employment agencies or job applicants) (Tsui, 1990). The fewer the constituencies impinging on the HRM department, the fewer discretionary constraints are likely. Having only a small number of constituents to deal with will likely serve to simplify the activities of the HRM department (Aldrich, 1979), and should serve to improve the discretionary ability of the human resource manager. Therefore:

Hypothesis 1: The smaller the number of external constituencies the HRM department must satisfy, the greater the discretion that will be available to human resource managers.

Another aspect of institutional pressures that may impact the level of human resource manager discretion concerns the content of institutional pressures. Here, organizational conformity to institutional pressures may be a function of the consistency and congruence of those expectations with the organization's existing goals and policies (Oliver, 1991). In HRM, it has been suggested that this congruence is likely to be stronger for public sector organizations. As such, the distinction between public and private sector organization has been used in previous human resource management research to address the notion that federal, state, and local governments can use their power to authorize or legitimate policies and structures that other organizations within the public sector will adopt (e.g., Goodstein, 1994). In contrast, in the private sector, conformity to institutional pressures may be precluded by organizational goals that give greater weight to other standards (e.g., technical or economic) against which firm performance is fundamentally evaluated (Oliver, 1991). Just as these processes have contributed significantly to the adoption of personnel policies in the public sector (Baron, Dobbin, & Jennings, 1986; DiMaggio & Powell, 1983), it is likely that these same processes will limit human resource manager discretion in the public sector. Public sector organizations, then, face "quasi-legal" constraints, and although they are not formally regulated, they are dependent on the government for a major portion of their budgets (e.g., public universities and hospitals). In these cases, power rests with the resource providers, and discretion is likely to be distinctly limited (Pfeffer & Salancik, 1978). Therefore:

Hypothesis 2: Human resource managers in private sector organizations will have more discretion than will human resource managers in public sector organizations.

Third, institutional control describes the ways in which institutional pressures are imposed on organizations (Oliver, 1991). There are two distinct processes by which such pressures are imposed on organizations: legal coercion and voluntary diffusion (Oliver, 1991). First, legal or government mandates are imposed by means of authority. Such institutional pressures typify coercive influence, which result from various pressures exerted on organizations; such influences result in organizational change as a direct response to government mandate. Legal requirements mandating human resource management policies and practices are likely to play a major role in the environmental context of HRM. In fact, the most important external environment for human resource management is the legal environment (Ledvinka & Scarpello, 1992). Changes in the legal environment have significantly changed the rules for the management of human resources. Not only are legal considerations a primary force shaping personnel policy (Ledvinka & Scarpello, 1992), but these issues are also an important constraint on human resource management decisions. Further, based upon the discussion herein, and the arguments of Hambrick and Finkelstein (1987), it seems likely that human resource executives in heavily regulated industries to have a relatively limited set of options such that:

Hypothesis 3: The lower the degree of legal coercion behind institutional requirements, the greater the discretion that will be available to human resource managers.

Another mechanism through which institutional influence occurs is voluntary diffusion (Oliver, 1991). As organizations adopt norms and practices, they are increasingly legitimated (Tolbert & Zucker, 1983). As these norms diffuse, organizations will increasingly incorporate these norms in an effort to enhance their legitimacy, to secure critical resources, and to remain competitive (Goodstein, 1994). Such institutionalization of organizational practices is likely to occur through processes of mimetic or normative isomorphism (DiMaggio & Powell, 1983). Mimetic influences, then, induce an organization's imitation of other organizational structures and practices, while normative influences exert pressure on organizations through professional relationships. As such, the ubiquity of certain kinds of management practices may be credited more to the universality of mimetic practices than to any discrete evidence that the adopted practices enhance efficiency (Davis & Powell, 1994). Furthermore, voluntary diffusion may also be the result of the formal and informal professional networks that span organizations and across which innovations may diffuse (Davis & Powell, 1994).

The extent to which an institutional expectation or practice has spread voluntarily will tend to predict the likelihood of conformity to institutional expectations (Oliver, 1991). Similarly, the amount of human resource discretion is likely to depend on perceptions of the diffusion of institutional norms and rules. Because managers are less likely to be aware of developing or narrowly diffused values and practices, low levels of diffusion are less likely to limit discretion. That is, while the broad diffusion and validation of HRM practices are likely to preempt strategic decision-making about the efficiency of such practices, when such practices are not broadly diffused or validated managers may be more skeptical or unwilling to conform; as such, discretion levels will typically be higher in such situations. Therefore:

Hypothesis 4: The lower the degree of voluntary diffusion of institutional norms, values, or practices, the greater the discretion that will be available to human resource managers.

Finally, the environmental context within which institutional pressures are exerted on organizations is also likely to be an important aspect of such institutional pressures (Oliver, 1991). Environmental uncertainty and interconnectedness are predicted to be significant dimensions of such context (Oliver, 1991). First, because organizational decision makers have a strong preference for certainty, stability, and predictability in organizational life (DiMaggio & Powell, 1983; Pfeffer & Salancik, 1978), environmental uncertainty will affect responses to institutional pressures. Organizations, for example, are more likely to imitate other organizations in contexts of environmental uncertainty. When managers have little knowledge about the relationship between means and ends, or when there is goal ambiguity, they tend to model their organizations after other organizations (Davis & Powell, 1994). In these cases, it is more likely that strategic decision-making will be preempted. In cases of environmental uncertainty, then, human resource managers will have limited discretion. Therefore:

Hypothesis 5: The lower the level of environmental uncertainty, the greater the discretion that will be available to human resource managers.

The level of interconnectedness in the institutional environment is also an important aspect of the institutional pressures facing organizations. Interconnected environments are said to provide "relational channels" that facilitate consensus on institutional norms (DiMaggio & Powell, 1983). High degrees of interconnectedness in an institutional environment, therefore, tend to promote isomorphism and conformity. Institutional environments are more likely to be interconnected when they contain many business, professional, and other membership organizations (e.g., political organizations and civic groups) (DiMaggio & Powell, 1983; Powell & DiMaggio, 1991). Because interconnectedness facilitates conformity and isomorphism with institutional elements, it is likely that such interconnectedness will also serve to limit discretion. As such, it is expected that:

Hypothesis 6: The lower the degree of interconnectedness in the institutional environment, the greater the level of discretion that will be available to human resource managers.

RESEARCH METHODOLOGY

The sample for this study was drawn from membership lists provided by regional chapters of a southern state's Society for Human Resource Management (SHRM). The data for this study were collected from three sources. First, a questionnaire was mailed directly to each of the 470 human resource managers obtained from the SHRM membership lists. Second, this mailing included a different questionnaire that was to be forwarded by the human resource manager to a member of top management not a part of the human resource function. Finally, archival data on unemployment rates were provided to the researcher by the Department of Labor.

The initial contact in each organization was the human resource manager. The five-part human resource manager questionnaire was designed to identify the HRM policies and practices in place at the focal organization, as well as to assess various characteristics of the human resource manager and the focal organization. The top manager questionnaire was designed to assess more general aspects of the focal organization (e.g., perceptions of the industry) and to provide data that could be used to assess the reliability of human resource manager responses. A case was considered valid only if both the human resource management and top management questionnaires were returned. A total of 109 usable questionnaires (23% response rate) were returned from the human resource manager respondents. A total of 112 usable questionnaires (24% response rate) were returned from top manager respondents. The final sample size (i.e., both the human resource manager and top manager questionnaires were returned) was 104 organizations (22% response rate).

Measures

To assess the impact of *institutional constituents* on HRM, two variables were measured: the *number of constituents* and the *multiplicity of demands*. First, to assess the number of institutional constituents affecting HRM, a list of constituents adapted from the work of Tsui (1990) was used. This list was presented to respondents, who were asked to indicate the degree to which they interact with each group when conducting their day-to-day business. A five-point Likert scale anchored by "no interaction" and "a great deal of interaction" was provided to respondents to identify their level of interaction. Second, respondents were asked to indicate the degree to which the groups identified as HRM constituents exert conflicting pressures on them. This was done in an effort to assess the *multiplicity of demands*, a variable with suggested importance when examining acquiescence to institutional demands (Oliver, 1991). Five items developed for this research were used to assess the degree to which constituents exert conflicting pressures on HRM. A five-point Likert scale anchored by "strongly agree" and "strongly disagree" was provided to respondents; the measure was coded so that higher values indicated higher levels of conflicting influence (alpha = .89).

To operationalize the *content of institutional demands*, data provided about the organization by top manager respondents were used to classify the distinction between public and private sector organizations in the sample. A dichotomous variable was created in which a "0" designated a private sector organization and a "1" designated a public sector organization.

Two variables were used to assess *institutional control*, the means by which institutional pressures are imposed on organizations: *legal coercion* and the *diffusion of HRM policies and practices*. First, a measure of legal coercion was developed for this study. Previously, research has suggested that legal coercion should be tapped by measuring not only the degree of legal and regulatory rules governing an organization, but also the scope of sanctions for noncompliance (Oliver, 1991). Therefore, the effect of the legal environment on HRM was measured using six items designed to assess the degree of legal coercion facing the HRM function and the degree of sanctions for noncompliance with the laws and regulations governing HRM (alpha = .71).

The second measure of institutional control focused on human resource manager perceptions of the diffusion of HRM policies and practices. Human resource manager respondents were asked to assess the degree to which they felt that coercive, mimetic, normative, and strategic factors influence the structure and content of HRM in their organization As noted earlier, these influences have been identified as important indicators of the means by which institutional pressures are imposed on organizations. Four two-item scales developed for this research based on work by DiMaggio and Powell (1983) were designed to measure perceptions of coercive (alpha = .97), mimetic (alpha = .93), normative (alpha = .93), and strategic (alpha =

.95) influences. A five-point Likert scale anchored by "strongly agree" and "strongly disagree" was provided to respondents. The measures were coded so that higher values indicated perceptions of higher levels of influence.

To assess the *institutional context* within which environmental pressures are exerted, two categories of variables were examined: *environmental uncertainty* and the level of *interconnectedness* within the institutional environment. First, environmental uncertainty was measured using six items adapted from the work of Duncan (1972) on perceived environmental uncertainty (alpha = .72). These items were used to assess: 1) state certainty, the human resource manager's ability to understand the major events and trends in an environment; 2) effect certainty, his or her ability to understand what effects an environmental event or change will have on an organization; and 3) response certainty, the ability of the human resource manager to understand what the response options to an environmental change are, as well as the likely effectiveness of each for achieving desired organizational outcomes. Second, the degree of interconnectedness within an institutional environment was measured using a methodology similar to that used by Ritzer and Trice (1969). Human resource managers were asked to indicate the number of business, professional, and membership organizations to which they belong, as well as their level of activity (zero through three, where zero indicates "inactive" and three indicates "very active") in each.

Measures of *human resource manager discretion* were developed for this study. Researchers have not yet developed measures of discretion to use in organizational research. Following previous suggestions (e.g., Hambrick & Finkelstein, 1987), human resource manager discretion was operationalized with multiple measures. In particular, three indicators measuring three dimensions of discretion were used in this study.

First, based on a review of the organizational literature, "structural discretion" was operationalized by measuring the extent to which decision-making rules are present in the human resource manager's job. The decision to operationalize structural discretion in this manner is consistent with suggestions of previous literature, which has argued that theory and research on discretion may benefit from focusing on the strength of the situation (e.g., how clear-cut or unambiguous the situation is) to measure discretion (Hambrick & Abrahamson, 1995). Formalization, then, was measured with five items administered to human resource management respondents. A five-point Likert scale anchored by "strongly agree" and "strongly disagree" was provided to respondents; the measure was coded so that higher values indicated higher levels of discretion (alpha = .84).

Next, human resource managers were asked to assess the "general discretion" in their jobs. Based on a review of previous literature on discretion and autonomy, three items were created to assess the extent to which the human resource manager's job offers choice and opportunity. General discretion was measured with three items administered to human resource management respondents. A five-point Likert scale anchored by "strongly agree" and "strongly disagree" was provided to respondents; the measure was coded so that higher values indicated higher levels of general discretion (alpha = .77).

Finally, human resource managers were asked to assess discretion in specific HRM decision areas. Previous research has suggested that the examination of discretion in specific decision areas is important to improve the measurement of discretion (e.g., Hambrick & Finkelstein, 1987). Eight important human resource management activities, identified in previous research by Tsui and Milkovich (1987), were used to assess specific discretion. These eight human resource management activities included: (a) staffing / human resource planning, (b) organization / employee development, (c) compensation / employee relations, (d) employee support, (e) legal compliance, (f) labor/ union relations, (g) policy adherence, and (h) administrative services. Because over one-third of respondents (n = 38) indicated that the item regarding labor / union relations was not applicable to their organization, this item was deleted; the remaining seven items were summed to assess specific discretion (alpha = .80).

To further assess the reliability of measurement of specific discretion, top management respondents were also asked to evaluate the specific discretion of the human resource managers. Top management, while expected to be familiar with the activities of the human resource manager, obviously cannot observe the human resource manager at all times. Despite this, however, previous research has suggested that the perceptions of others are important in the assessment of discretion (e.g., Hambrick & Finkelstein, 1987). Therefore, to assess the overall accuracy of the measure of specific human resource manager discretion, the same items described above that were administered to human resource management respondents were also given to top management respondents. Human resource management and top management evaluations of discretion were moderately correlated ($r = .45$). Absent any established criteria to evaluate the magnitude of this correlation as an indicator of agreement, the relative magnitude of the correlation between top and human resource manager evaluations of specific discretion does seem to indicate that there is some consistency between the two respondents in their evaluations of discretion.

Three control variables were also included in these analyses. Each has been proposed to be an important factor influencing the management of human resources (e.g., Schuler & Jackson, 1995). First, *union status* was measured based on the report of the human resource management respondent. A dichotomous variable was created so that a "1" designated the presence of a union and a "2" designated no union. Second, the *competitive rivalry* facing the focal organization has been suggested as an important factor influencing both the structure and content of HRM (e.g., Schuler & Jackson, 1995), as well as the discretion available to managers in an organization (Hambrick & Finkelstein, 1987). Competitive rivalry was measured based on the report of the top manager respondent, who was asked to indicate the instability of the competitive rivalry facing their organization. This measure was coded so that higher scores indicated higher levels of competitive rivalry facing the organization. Finally, the *industry* in which the organization competes was included as a control variable in the analyses. Industry has been consistently used as an important variable in previous HRM research (Schuler & Jackson, 1995). Industry was measured based on the report of top management respondents. Top management respondents were presented a list of nine primary industries, and were instructed to pick the primary industry in which their organization does business.

ANALYSES AND RESULTS

The hypotheses were tested using multiple regression analysis. Control variables, including union status, competitive rivalry, and industry, were included in all analyses. Hypothesis 1 predicted that human resource manager discretion would be negatively associated with the number of institutional constituencies affecting the HRM department. No support for Hypothesis 1 was found. Neither the number of institutional constituencies, nor the multiplicity of demands exerted by the constituencies affecting HRM was a significant predictor of any of the three indicators of human resource manager discretion.

Hypothesis 2 predicted that human resource managers in private sector organizations would have more discretion than those in public sector organizations. This hypothesis was supported with respect to structural discretion. Specifically, the distinction between public and private sector organization was a significant predictor of structural discretion ($\underline{b}$ = 3.11, $\underline{p}$ # .001) As expected, public sector organizations were associated with higher levels of formalization, indicating lower levels of human resource manager discretion.

Hypothesis 3 predicted a negative relationship between human resource manager discretion and the degree of legal coercion facing the HRM function. This hypothesis was supported with respect to structural discretion. The degree of legal coercion facing the HRM department was a significant predictor of structural discretion ($\underline{b}$ = .35, $\underline{p}$ # .05). As expected, greater degrees of legal coercion were associated with higher formalization, indicating lower levels of human resource manager discretion.

Hypothesis 4 predicted that perceptions of the diffusion of institutional norms, values, and practices would explain the level of human resource manager discretion. Partial support was found. Two of the perceptions of diffusion (coercive and rational influences) were significant predictors of human resource manager. Voluntary diffusion of HRM practices (normative and mimetic forces) were not significant predictors of any indicator of human resource manager discretion.

Hypothesis 5 predicted a negative relationship between the human resource manager's environmental uncertainty and his/her level of discretion. This hypothesis was supported with respect to general discretion. Specifically, the degree of environmental uncertainty facing the human resource manager was a significant predictor of general discretion ($\underline{b}$ = -.24, $\underline{p}$ # .001). As expected, greater degrees of environmental uncertainty were associated with lower levels of choice and opportunity, indicating lower levels of human resource manager discretion.

Hypothesis 6 predicted that the degree of interconnectedness in the institutional environment would be negatively associated with the level of human resource manager discretion. This hypothesis was supported with respect to both structural and general discretion. When specific discretion was the focal dependent variable of interest, however, the hypothesis was not supported. In particular, the human resource manager's level of activity in membership organizations was positively related to formalization, indicating lower levels of discretion ($\underline{b}$ = .34, $\underline{p}$ # .10). Further, both the number of business, professional, and membership organizations to which the human resource manager belongs ($\underline{b}$ = .58, $\underline{p}$ # .05) and the sum of the activity level in these organizations ($\underline{b}$ = -.21, $\underline{p}$ # .05) were significant predictors of general discretion, the extent to which the human resource manager perceives that his/her job offers choice and opportunity.

DISCUSSION

In general, the results of our study indicate that human resource manager discretion is affected by the organization's institutional environment. In support of Hypothesis 2, for example, the distinction between public and private sector was found to be significantly associated with structural discretion. Human resource managers in public sector organizations were more likely to have formalized human resource manager positions. This finding supports previous contentions that the congruence between institutional pressures and organizational goals is particularly strong for public sector organizations. The limiting influence on the discretionary sets of human resource managers in public sector organizations, which has been suggested by previous literature, was supported by this study.

Governments at the federal, state, and local level often use their power to authorize policies and structures that organizations within the public sector adopt (Scott, 1987). These processes have contributed to the wide adoption of personnel policies such as affirmative action and due process (Baron, Dobbin, & Jennings, 1986; DiMaggio & Powell, 1983). Because public organizations are dependent on the government for a major portion of their budgets, power rests more with the resource provider (Pfeffer & Salancik, 1978) than with individual managers. Managerial characteristics associated with choice, such as discretion, are more likely to be limited. Salancik and Pfeffer (1977), for example, in their study of the effects of individual mayors on managerial practices, found that mayors had the least discretion over budget categories that were subject to pressure from powerful constituencies (e.g., police and highways). This is consistent with arguments in previous literature and the findings here: human resource managers in public sector organizations are more likely to be expected to act within "accepted bounds" (e.g., Hambrick & Finkelstein, 1987).

Support for Hypothesis 3 -- a negative relationship between human resource manager discretion and the degree of legal coercion facing the HRM function -- was found in the relationship between legal coercion and structural discretion. As hypothesized, higher levels of legal coercion were associated with higher levels of formalization. Previous research has suggested that an important force for institutional control, the means by which pressures are imposed on organizations, is legal coercion. This study found that legal constraints are an important correlate of structural discretion. These results, in particular, indicate that legal constraints (both the perceptions of the degree to which laws and regulations impact the management of HRM and the extent to which sanctions for noncompliance are severe) impact the amount of choice, or discretion, available to the human resource manager.

In support of Hypothesis 5, human resource managers' levels of environmental uncertainty were negatively associated with general discretion. In particular, results indicated that human resource managers with lower levels of environmental uncertainty were more likely to perceive higher levels of choice and opportunity in their jobs. Both institutional and resource dependence theorists suggest that organizational decision makers have a strong preference for certainty, stability, and predictability (DiMaggio, 1988; Pfeffer & Salancik, 1978). Organizational literature has focused on the fact that organizational decision makers may strive to make rational (e.g., fully informed) decisions, but they often find themselves making decisions with less than complete information. In an "information vacuum" (e.g., a situation with high environmental uncertainty), managers are more likely to pursue options that have little to do with either efficiency or goal attainment (Galaskiewicz & Wasserman, 1989). The finding here that environmental uncertainty is associated with human resource manager discretion may provide insight into the underlying nature of this proposed relationship. Perhaps the reason that environmental uncertainty affects organizational structure is that discretion limits the choice and activeness managers have in shaping those structures.

The proposed relationship between the interconnectedness of the institutional environment and the level of human resource manager discretion was also supported by the results of the analyses. As predicted, human resource managers who reported higher levels of interconnectedness also perceived higher levels of both structural and general discretion. An interconnected environment, one in which the organizational actor is a member of many business, professional, and other membership organizations, is said to provide relational channels that facilitate consensus on institutional norms (DiMaggio & Powell, 1983; Meyer & Rowan, 1977). As such, business and professional circles have a set of "routine" or "acceptable" solutions to certain managerial or professional problems (Galaskiewicz & Wasserman, 1989). Further, these solutions may be institutionalized in the occupational subculture of the profession (e.g., human resource management). These standards of behavior are communicated to managers through the various professional, business, and membership organizations to which they belong. Further, it has been suggested that because of their societal or professional values and norms, managers pursue strategies without reflecting on alternative courses of action or consciously weighing options (Galaskiewicz & Wasserman, 1989).

The results of this study support these assertions -- higher levels of interconnectedness were associated with lower levels of discretion. Interestingly, the findings of these analyses also point to an interesting notion about the measurement of interconnectedness. The activity level of the human resource manager in the various business and professional organizations was the important predictor of discretion. The number of organizations to which the human resource manager belongs, on the other hand, was not a significant predictor of discretion. In fact, the correlation between the two variables was positive. This seems to indicate that a more accurate assessment of interconnectedness is the *extent* to which an organizational member is involved in various business, professional, and other membership organizations, rather that a simple *count* of the number of organizations to which the manager belongs. Past research (e.g., Goodstein, 1994) has operationalized interconnectedness as a simple count of the number of the business, professional, and membership organizations within a particular area. This research has not found any support for the proposed relationship between interconnectedness and employer responses, and in fact, it has suggested that a finer-grained measure might better capture the true nature of environmental connectedness. To more accurately assess the interconnectedness of an organizational actor's institutional environment, the findings of this study indicate that future research should consider using the *level of activity* that an organizational member has in the various business, professional, and other membership organizations to assess interconnectedness.

IMPLICATIONS / CONCLUSION

The findings of this study have important implications for future research focusing on the integration of choice (i.e., strategic human resource management) and deterministic (i.e., institutional) approaches to human resource management. A central debate in the organizational literature revolves around the extent to which managers or environments exercise predominant influence over organizational outcomes (Romanelli & Tushman, 1986). While research has suggested that choice and determinism should be juxtaposed to develop an interactive view of organizational adaptation processes (Hrebiniak & Joyce, 1985), such efforts have not yet been made in the area of human resource management. Based on the findings of this study, choice and deterministic views of human resource management may, in fact, be complementary. Human resource managers create and adjust organizational practices, but do so within institutional constraints that limit their discretion to take action (Pfeffer & Salancik, 1978).

Hambrick and Finkelstein (1987) argued that when discretion is low, the role of management is limited, and strategic explanations of organizational outcomes have less utility. On the other hand, when discretion is high, managers can significantly shape the organization and strategic explanations will be reflected in organizational outcomes. Implied in the findings of our research is that in order to predict changes in an organization characterized by low discretion, one need focus on what is going on in its environment. In a high discretion firm, on the other hand, changes in the structure and content of human resource management practices will not necessarily be tied to changes in the environment. That is, discretion on the part of the human resource manager will improve his/her ability to gather and process information, to identify and negotiate alternate courses of action, and, perhaps, to select and implement human resource management practices to support firm strategy. We believe this study has added empirical evidence to the growing area of human resource management research, especially regarding the roles of institutional and strategic choice variables in the shaping of human resource practices.

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DO LAYOFF PRACTICES MATTER? THEIR RELATIONSHIP TO COMMITMENT AND PERCEIVED ORGANIZATIONAL SUPPORT OF PERMANENT AND TEMPORARY EMPLOYEES

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ABSTRACT

This paper examines the impact of human resource management (HRM) practices regarding layoffs and the use of temporary workers on perceived organizational support (POS and organizational commitment. The results indicate that the use of temporary workers with respect to layoff practices has a strong relationship with on the level of POS and commitment experienced by permanent workers.

INTRODUCTION

As organizations have moved to flatter and leaner structures, such changes are frequently accompanied by significant downsizing. The associated reduction in job security, along with a decline of real wages, and continual demands for increased production has coincided with a general deterioration of worker commitment to the employing organizations as well as a decline in worker perception of the degree to which the organization in committed to them.

In conjunction with structural changes, the use of temporary workers has increased in the United States for a number of reasons (Investor's Business Daily, 1995). These reasons include providing the organization with a flexible work force, freeing the organization from a number of human resource management (HRM) tasks, allowing the organization to evaluate workers prior to hiring them on a full time basis, and, in some cases shielding permanent workers from layoffs. With respect to this last point, the purpose of this study is to examine the effects of layoff practices as they relate to temporary versus permanent workers and the effect that such practices have on the commitment workers have for their employing organizations and their perception of the commitment they receive from these organizations.

PERCEIVED ORGANIZATIONAL SUPPORT AND ORGANIZATIONAL COMMITMENT

Commitment has been viewed as such an important issue that a recent human resources text book devoted a special section to "building employee commitment" in 12 of its 19 chapters (See Dessler, 1994). Workers concur: more than 96% of employees responding to a 1993 Industry Week survey considered employee commitment to an organization to be critical to its success or failure. Unfortunately, over 87% of these same employees felt that the level of this commitment is lower now than 5 years previously and is, in fact, "... all but gone" (Moskal, 1993: 11). Reduction in employee commitment is not surprising given the extensive company downsizing, deterioration of real wages, and continual demands for increases in productivity mentioned above. This situation is particularly sobering since research shows that organizational commitment has a positive effect on such organizationally valued outcomes as extrarole behavior (Bishop, Burroughs, & Scott, 1998; Gregersen, 1993; Morrison, 1994), job performance (Bishop, Burroughs, & Scott, 1998; Gregersen Brett, Cron, & Slocum, 1995; Mathieu and Zajac, 1990), and lower turnover (Bishop, Scott, & Casino, 1997; Mathieu and Zajac, 1990)

Although the literature offers several definitions and measures of organizational commitment (Mathieu & Zajac, 1990), the Mowday, Porter, and Steers (1982) definition and its measure, the Organizational Commitment Questionnaire (OCQ), are the most widely used and they were used in this study. Organizational commitment is the relative strength of an individual's identification with and involvement in a particular organization and can be characterized by (a) a strong belief in and acceptance of the organization's goals and values; (b) a willingness to exert considerable effort on behalf of the organization; and (c) a strong desire to maintain membership in the organization.

Recent conceptual and empirical work on commitment in the work place suggests that commitment is not a unidirectional phenomenon. Eisenberger, Huntington, Hutchison, and Sowa (1986) point out that the conceptualization of commitment also encompasses the attachment that employees perceive that entities within the organization have for them. In particular, they discuss the organization's commitment to its employees. They refer to the degree to which employees believe that their employing organization has commitment for them as perceived organizational support (POS). POS is the degree to which employees believe that the organization values their contribution and cares about their well-being (Eisenberger, et al., 1986).

POS is an essential component of the exchange relationships associated with organizational commitment (Bishop, 1998; Wayne, Shore, & Liden, 1997). Social exchange theory proposes that when one person or entity does a favor for another, the recipient of the favor is obliged to reciprocate (Blau, 1964), though the details of when and in what form are unspecified (Gouldner, 1960). Using social exchange theory and the norm of reciprocity (Gouldner, 1960), POS has been hypothesized to have a positive relationship with organizational commitment and empirical results have supported this hypothesis (Bishop, Burroughs, & Scott, 1998; Eisenberger, et al., 1986; Settoon, Bennett, & Liden, 1996; Wayne, Shore, & Liden, 1997). The theory behind this exchange relationship is that employees experience affective commitment for the company when they perceive that the company provides support to them.

The norm of reciprocity has a "division of labor" component which states that reciprocation will be made in terms of goods and services that are of value to the object of the reciprocation and is within the capability of the donor (Gouldner, 1960). More specifically, when an individual believes that the organization values his or her contribution to the organization and cares about his or her well-being, then the individual will be inclined to reciprocate by putting forth greater effort on behalf on the organization. Furthermore, the individual who perceives and receives such supporting consideration may make the interpretation that such consideration represents underlying organization values and internalize them. That is, this component of commitment is enhanced by the individual's reaction to high levels of POS. Therefore, an exchange relationship will take place between the individual and the organization that will result in important and necessary advantages and benefits for both.

One of the characteristics of the exchange relationship is that it develops over time. Part of this development is that a pattern of reciprocity is conceived to determine the equity of the balance in the exchange (Rousseau, 1989). The concept of POS was developed to explain the development of employee commitment to the organization (Eisenberger, et al. 1986), and the crux of the explanation is that the development of organizational commitment has a strong basis in social exchange theory.

Therefore, events, circumstances, policies, practices, and issues that interrupt this exchange relationship should have a deleterious effect on POS and, subsequently, on organizational commitment.

HUMAN RESOURCE MANAGEMENT PRACTICES

As the employment relationship clarifies itself over time, employees develop psychological contracts, or sets of expectations, with respect to what their employer expects from them and what they can, in turn, expect from their employer (Rousseau, 1989). Therefore, it is reasonable to expect that HRM practices contribute to the development of such expectations. With regards to the research question considered here, an organization may expand or shrink its work force by using greater or lesser amounts of temporary workers. Thus, its HRM practice could be described as one designed to shield its permanent workforce from layoffs through the use of temporary workers. An alternative to this practice is to select those to be laid off without consideration of permanent or temporary status.

When an employer shields permanent employees from layoffs caused by external factors, such as a business cycle, or internal decisions, such as downsizing, the organization is signaling to employees that it values their contribution to the organization and cares about their well-being. To the extent that employees perceive this action as evidence that the employer "values their contribution and cares about their well-being" POS at some relatively high level, then correspondingly high levels of POS will be present. Such shielding actions by the employing organization reinforce the exchange relationship of commitment to the employee by the organization (POS) and commitment to the organization by the employee. Social exchange theory suggests that as employees experience high levels of POS, they will reciprocate with high levels of organizational commitment.

On the other hand, if the employer lays off both permanent and temporary workers without regard to the temporary/permanent status, the employer is interrupting this exchange relationship and is signaling its permanent employees that their contribution and well-being are valued at a relatively low level. That is, the organization is signaling its employees that it is, at best, ambivalent about their contribution to it and is demonstrating that it cares little about their well-being. In this way, the POS organizational commitment exchange relationship is interrupted and according to social exchange theory, the resulting reduced level of POS will be accompanied by a corresponding and reciprocating reduction in organizational commitment.

Temporary workers, on the other hand have different expectations based on the terms and conditions of their employment. Being "let go", while not particularly desirable, would be perceived as part of being a temporary worker. Based on this reasoning,

Hypothesis 1a: Permanent workers in environments which use temporary workers to shield them from layoff will experience higher levels of POS than permanent workers in environments which layoff without regard to permanent/temporary status.

Hypothesis 1b: Permanent workers in environments which use temporary workers to shield them from layoff will experience higher levels of organizational commitment than permanent workers in environments which layoff without regard to permanent/temporary status.

Hypothesis 2a:	In environments in which the layoff practice makes use of temporary workers to shield permanent workers from layoff, permanent workers will experience higher levels of POS than will temporary workers.
Hypothesis 2b:	In environments in which the layoff practice makes use of temporary workers to shield permanent workers from layoff, permanent workers will experience higher levels of organizational commitment than will temporary workers.
Hypothesis 3a:	In environments in which the layoff practice does not use temporary workers to shield permanent workers from layoff, temporary workers will experience higher levels of POS than will permanent workers.
Hypothesis 3b:	In environments in which the layoff practice does not use temporary workers to shield permanent workers from layoff, temporary workers will experience higher levels of organizational commitment than will permanent workers.

METHODS

Participants and Setting

The sample for this study came from two plants, both outsource suppliers for automobile manufacturing plants. The companies were not affiliated with each other. They were about 60 miles apart and located in the mid-Atlantic region. Both plants made significant use of temporary workers. In both cases the temporary workers were employed through temporary employment agencies. Both organizations made use of the temporary work arrangement as a selection device to hire permanent workers when it was decided that additions were needed to the permanent work force. However, the organizations differed in terms of their respective layoff practices. One plant (hereafter referred to as the "layoff" plant) would layoff without regard to the temporary/permanent status. Consequently permanent workers were being laid off and recalled relatively frequently. In fact this had occurred twice in the past five years. About 25% of the workers in the plant had been laid off and recalled at least once during that time span. In contrast, the other plant (hereafter referred to as the "shield" plant) used the temporary workers as a shield, or buffer, between the permanent workers and possible layoff. Over the same five year period, while faced with the same business cycles in the same industry, the "shield" plant was able to avoid layoffs for its permanent workers. The size of the temporary work force did fluctuate accordingly.

Procedure

A total of 160 and 210 production employees took part in the survey from the "layoff" and "shield" plants, respectively. This represented all employees who were present during the day of the survey administration. The respondents completed the survey on company time and were compensated accordingly. A total of 6 and 5 surveys had to be dropped from the respective samples because of subjects' inability or unwillingness to complete the survey. The final sample sizes were 135 and 172 permanent workers and 19 and 33 temporary workers at the "layoff" and "shield" plant, respectively. Demographically, the samples from the two plants were relatively homogeneous. The average ages of the employees at the "layoff" plant were 40.7 years (permanent) and 33.1 years (temporary); at the "shield" plant the ages were 39.3 and 32.2, respectively. The respondents were mostly white, 83%, 94%, 84%, and 90%, respectively; slightly more female, 51%, 58%, 53%, and 55%, respectively; most had finished high school (79%, 78%, 88%, and 88%). Of the permanent workers at the two plants 60% ("layoff") and 55% ("shield") had been with their respective company 10 years or longer.

Measures

POS was measured with the nine item shortened version of the scale developed by Eisenberger, Huntington, Hutchison, and Sowa (1986) and refined by Wayne, Shore, and Liden (1997). The nine item short form of the Organizational Commitment Questionnaire (OCQ; Mowday, Steers, & Porter 1979) was used to measure organizational commitment. For both scales employees indicated the extent of their agreement to the nine items on a scale ranging from strongly disagree (1) to strongly agree (7). The coefficients alphas for the POS and organizational commitment scales were, .90 and .88, respectively.

RESULTS

Prior to testing the hypotheses, a confirmatory factor analysis (CFA) was conducted on the POS and organizational commitment constructs. The results indicated that the model fit the data moderately well. The hypothesized two-factor model was compared with a one factor model to determine if, indeed, two separate constructs were being measured. Comparisons of the two models indicated that the scales did measure separate and distinct constructs. The results appear in Table 1. We also confirmed that POS and organizational commitment were positively correlated (r = .55, $\underline{p} < .001$), a result that was consistent with prior research (cf. Wayne, Shore, & Liden, 1997).

TABLE 1

Results of Model Comparisons

Model	χ^2	df	RMSEA	Comparative Fit Index	Tucker-Lewis Fit Index	$\Delta\chi^2$ (df) from Hypothesized
Two Factor (hypothesized)Model	251.29	134	.074	.92	.91	n/a
One Factor Model	550.20	135	.139	.72	.68	298.91 (1)

In order to test the hypotheses, the data were subdivided into four groups: (1) "shield" plant permanent workers, (2) "shield" plant temporary workers, (3) "layoff" plant permanent workers, (4) "layoff" plant temporary workers. Two one-way ANOVAs were run on the data to determine if there were differences in the respective means of the POS and organizational commitment variables among the four groups. The analysis included both Duncan's Multiple Range Test and Tukey's Studentized Range Test in order to test which means were different from the others.

The results of the ANOVA for the POS construct are presented in Table 2. The results of the Duncan and Tukey tests were the same (See Table 3). The overall F-test indicated that at least one of the means was significantly different from the others. The Duncan and Tukey tests gave the same result and indicated that the means of POS for permanent workers in the "shield" plant differed significantly from the mean of the permanent workers in the "layoff" plant and that of the temporary workers in their own (the "shield") plant. This provided support for hypothesis 1a and hypothesis 2a, respectively. The mean of POS for temporary workers in the "layoff" plant was significantly higher than that of the permanent workers in the same plant. Thus hypothesis 3a was supported.

TABLE 2

Results of ANOVA for Perceived Organizational Support

Source	DF	SS	MS	F
Model	3	92.50	30.83	46.56 $p < .0001$
Error	355	235.09	0.66	
Corrected Total	358	327.60		
$R^2 = .28$				

TABLE 3

Means of POS and Results of Duncan Test and Tukey Test *

"Layoff" Perms		"Layoff" Temps		"Shield" Temps		"Shield" Perms
A		B		B		C
3.55		4.08		4.11		4.65

* Means with the same letter are not significantly different.

The results of the ANOVA for the POS construct are presented in Table 2. The results of the Duncan and Tukey tests were the same (See Table 3). As with POS, the overall F-test for organizational commitment indicated that at least one of the means was significantly different from the others. As to the specific means, the Duncan and Tukey tests indicated that organizational commitment for permanent workers in the "shield" plant differed significantly from that of the permanent workers in the "layoff" plant and the temporary workers in the "shield" plant. This provided support for hypothesis 1b and hypothesis 2b, respectively. Even though the mean of organizational commitment for temporary workers in the "layoff" plant was higher that that of permanent workers in the "layoff" plant, the difference was not significant. Thus hypothesis 3b did not receive support.

TABLE 4

Results of ANOVA for Organizational Commitment

Source	DF	SS	MS	F
Model	3	58.96	19.65	21.52 $p < .0001$
Error	353	220.15	0.62	
Corrected Total	356	279.11		
$R^2 = .21$				

TABLE 5

Means of Organizational Commitment and Results of Duncan Test and Tukey Test*

"Layoff" Perms	"Layoff" Temps	"Shield" Temps	"Shield" Perms
A	A	A	B
3.71	3.99	4.00	4.59

* Means with the same letter are not significantly different

DISCUSSION AND CONCLUSIONS

The results of this study contribute to the human resource management literature in a significant and important way. It is the first study to link two HRM issues, layoff practices and the use of temporary workers, to the exchange relationship between the organization and its employees. More specifically, it shows that the nature of the exchange relationship regarding commitment between organizations and their permanent workers can be significantly influenced by human resource management practices.

This study is also important to practicing managers. Its results suggest that an organization should coordinate its layoff practices with the use of temporary workers. The organization should carefully consider how it wishes to be perceived by its employees. Though it was not hypothesized in this study, the level of POS for temporary workers in the "shield" company did not significantly differ from the level of POS for the temporary workers in the "layoff" company. It would seem then, that the level of POS of temporary workers is rather unaffected by layoff practices. A possible explanation for this is that temporary workers may feel that they are getting what they have bargained for and that the organizations is not violating their psychological contract in the event that it terminates their employment with little notice. Future research should focus on the degree to which such human resource management practices affect other attitudes of temporary workers. For example, specific HRM practices may influence temporary workers' desire to join the organization in the future.

This study, like all field studies, has a number of limitations. First, the sample sizes of the temporary workers were relatively small. This limited the type of data analysis techniques that could be employed and, therefore, the sophistication of the theoretical model that could be tested. Second, layoff practices are arguably an important influence on employee attitudes toward the organization. However, such practices are clearly not the only factors related to POS and organizational commitment. This statement is supported by the results of hypothesis 3b. The lack of support for this hypothesis provides and empirical indication that antecedents other than layoff policies operate employees' levels of organizational commitment. The level of organizational commitment of permanent workers in the "layoff" plant was lower that that of the temporary workers in both of the plants but not significantly so. If the HR policy was the only influence on organizational commitment this difference should have been significant.

Some potential influences that were not considered in this study include developmental experiences, promotions, and organizational tenure have all been shown to be related to POS (Wayne, Shore, & Liden, 1997). Some other possible influences on POS and organizational commitment that were not considered may include compensation schemes, organizational culture, and human resource management policies and practices other than those related to layoffs.

Even with the above limitations, one strength of this study is that the plants were in the same industry. This provided for one element of control since employee expectations with regards to organizational support are likely to be shaped and influenced by norms for the industry in which they work.

Based on this study's limitations, future research should focus on other influences of POS and organizational commitment in organizations with different HR policies. The variables mentioned above could be used as control variables in reexamining the relationship between HRM practices, POS, and organizational commitment. A larger sample size would be a necessary condition to achieve this objective. HRM policies and practices other than layoff practices should be examined, not only for their direct effects, but also for interaction effects on POS and organizational commitment. POS and organizational commitment have been shown to be important independent variables in the study of a number of important organizational outcomes such as intention to quit, organizational citizenship behavior, and performance ratings (Wayne, Shore, & Liden, 1997). The degree to which layoff practices may influence these variables directly, as well as indirectly through POS organizational commitment, should be examined.

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CORPORATE ACQUISITIONS AND MERGERS: AN ALTERNATIVE INQUIRY INTO THE RELATIONSHIP BETWEEN CORPORATE DIVERSIFICATION AND PERFORMANCE

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ABSTRACT

Extensive research into the relationship between corporate diversification and economic performance has been conducted by strategic management researchers using Rumelt's (1974) notion of product-market relatedness to explain performance differences among diversified firms. Rumelt (1974) hypothesized that firms which diversify into areas related to the original business by either products or markets would financially outperform those firms that diversify into areas unrelated (in a product or market sense) to the original business. An alternative perspective for studying the relationship between corporate performance and diversification is proposed in this paper. Other dimensions of relatedness, such as the strategic similarity between a corporation's business units, may provide alternative means of defining relatedness. It will be argued that a redefinition of relatedness will prove valuable in expanding our ability to predict the effect corporate diversification strategy has on corporate performance.

INTRODUCTION

We are in the midst of the greatest wave of mergers in American history reports *Fortune* magazine's February 17,1997 article entitled "Sale of the Century". It states that the annual value of mergers and acquisitions has grown from approximately 200 billion dollars in 1985 to over 650 billion dollars a decade later (Whitford, 1997). *Fortune*'s opinion echoes *The Wall Street Journal*'s article of Friday, October 4, 1996 entitled "Firm's Urge to Merge Stays Strong" (Lipin, 1996). Both these articles continue to remind us of the trend in mergers and acquisitions that has proceeded at a rapid pace since World War II. In fact, two-thirds of *Fortune* 500 firms were diversified by 1970 and similar patterns of diversification existed in both Western Europe and Japan. Consequently, interest in the relationship between corporate diversification and the economic performance of the firm has grown in both the public and private sectors (Bettis & Hall, 1982).

Extensive research into the relationship between diversification and economic performance has been conducted using two different perspectives. One perspective examines the impact diversity (on a continuum from highly diversified to no diversification) has on a firm's performance. Although this perspective hypothesizes that highly diversified firms should outperform less diversified ones, empirical research (Arnold, 1969; Gort, 1962; Markham, 1973) does not support this position.

A second perspective utilizes Rumelt's (1974) notion of product-market relatedness to explain performance differences among diversified firms. Researchers using this perspective have theorized that corporate performance is affected by the relatedness (in a product and/or market sense) of a firm's diversity. It is hypothesized that better corporate performance is obtained when the firm follows a related diversification strategy because this strategy provides greater opportunity to exploit synergies and reduce risk.

Blackburn and Shrader (1990) argue that "a consensus seems to be forming that related corporate acquisitions are superior to unrelated acquisitions" (p. 1). This consensus view is not without its critics, however. Other research results (see Barton, 1988) indicate that unrelated acquisitions need not produce inferior performance. This debate suggests that further research into the nature of the relationship between corporate diversification and its financial performance may be productive, especially if new ways of examining it can be devised.

This paper proposes an alternative perspective for studying the relationship between corporate performance and diversification. Product/market relatedness is not the only way relatedness can be conceived. Other dimensions of relatedness, such as the strategic similarity between a corporation's business units, may provide an alternative means of defining relatedness (Blackburn and Shrader, 1990). It will be argued in this paper that a redefinition of relatedness will prove valuable in expanding our ability to predict the effect corporate diversification strategy has on corporate performance.

LEVEL OF DIVERSIFICATION PERSPECTIVE

Industrial organization economists examined the impact diversity has on a firm's performance. They use product count measures based on the continuous Standard Industrial Code (SIC) to depict the level of firm diversity. There are several different product count approaches that can be used to measure diversity. One of the simplest approaches is derived from the ratio of primary industry output to total firm output (a measure of homogeneity). The complement to this ratio (a measure of diversification) gives the relationship of non-primary industry output to total output (Gort, 1962).

Another measure simply counts the number of industries in which a firm operates. This measure is very objective and easy to compute but an important limitation is that it gives undue weight to total dispersion if this activity accounts, in aggregate, for only a small proportion of the firm's total output (Gort, 1962).

One way to minimize the limitations of simple product count measures is to use some type of weighted index. Typical of weighted index measures are the entropy measure (Jacquemin & Berry, 1979) and the Berry-Herfindahl index (Montgomery, 1982). Weighted indexes consider not only the percentage of a firm's total sales in each of the SIC codes in which it participates but also the firm's share of each of those markets.

RELATEDNESS PERSPECTIVE

A second perspective, adopted by strategic management researchers, utilizes Rumelt's (1974) notion of product/market relatedness to explain performance differences among diversified firms. Researchers using this perspective have theorized that corporate performance is affected by the relatedness (in a product and/or market sense) of a firm's diversity. It is hypothesized that better corporate performance is obtained when the firm follows a related diversification strategy because this strategy provides greater opportunity to exploit synergies and reduce risk. Richard Rumelt (1974), building on the work of Wrigley (1970), was the first researcher to hypothesize that there would be a significant performance difference between related and unrelated diversification strategies.

Rumelt (1974) proposed nine specific diversification strategies a firm could pursue. Researchers have found it convenient and acceptable to collapse the nine strategies into the following four (Salter & Weinhold, 1979): firms committed to a single business (single product firms); firms primarily committed to a single business but with some diversification representing an insignificant part of the total business activity (dominant product); firms where significant diversification activity has taken place in areas bearing a product or market relation to current activities (related product); and firms where significant diversification activity has been undertaken without regard to such relatedness (unrelated).

Rumelt's typology is based on the degree of relatedness a new business has with the old businesses. Rumelt defined a related business as one in which more than 70 percent of the diversification had been achieved by relating new activities to old activities. Businesses are considered related if they serve similar markets and use similar distribution systems, employ similar production technologies, or exploit similar science based research (Salter & Weinhold 1979).

He defined an unrelated business as one in which less than 70 percent of the firm's diversification was related to its original skills or strengths. An unrelated diversifier pursues growth in product markets where the key success factors are unrelated to each other. Despite whether the firm is an actively managed conglomerate or a more passively managed holding company, it expects little or no transfer of functional skills between its various business units (Salter & Weinhold 1979).

Rumelt (1974) compared the performance of corporations pursuing related strategies with those corporations pursuing unrelated strategies. He found that related strategies produced higher performance than unrelated strategies. He also found significant performance differences between related firms based on the relatedness strategy they were pursuing. Related constrained firms (where each business unit of the corporation can be logically related to each and every one of the other business units) were found to have superior performance to related linked firms (those characterized by each separate business unit being logically related to at least one other business unit within the corporation).

Rumelt's (1974) findings motivated additional research into corporate diversification using his model of relatedness (for example see, Bettis, 1981; Christensen & Montgomery, 1981;

Palepu, 1985; Dubofsky & Varadarajan, 1987; Amit & Livnat, 1988; Blackburn & Shrader, 1990). Many of these studies modified and refined his notion of relatedness, and results have been inconclusive and sometimes contradictory.

A NEW PERSPECTIVE OF RELATEDNESS

This paper argues that relatedness in a diversified firm can be conceived of in a manner other than the traditional (product/market) dimension. Another dimension is the degree of similarity among the separate business unit strategies of a single corporation. Conceiving of relatedness in this way, it can be said that the greater the similarity of business level strategies among distinct business units of a corporation, the greater is the degree of relatedness between them, despite their product or market correlation. This type of relatedness is designated S-relatedness to distinguish it from product/market relatedness which is designated R-relatedness in this paper.

The strategic similarity perspective advances the idea that a corporate diversification strategy based on achieving similarity among business unit strategies will produce superior financial results for a firm. Dominant general management logic provides the theoretical underpinnings for this perspective.

Dominant Logic

The strategic similarity perspective develops its theoretical underpinnings from Prahalad and Bettis's (1986) idea of dominant general management logic (or simply dominant logic). Prahalad and Bettis (1986) define dominant logic as:

> a mindset or a world view or conceptualization of the business and the administrative tools to accomplish goals and make decisions in that business. It is stored as a shared cognitive map (or set of schemas) among the dominant coalition. It is expressed as a learned, problem-solving behavior (p. 491).

Dominant logic is a collective of the top management team's individual beliefs, theories and approaches to decision making, based on each manager's personal experience, that has developed over time. Ginsberg (1990) argues that groups don't "think per se but . . . draw upon the different cognitive abilities available among their membership . . . to collect and interpret information and to communicate among themselves" (p. 521). Without a dominant logic, the top management team would need to approach each new organizational event as if it were unique. Dominant logic permits managers to respond rapidly and efficiently to each organizational event without the need of analyzing systematically a large number of ambiguous and uncertain situations (Prahalad & Bettis, 1986).

A major implication of the notion of dominant logic on diversification strategy is that the ability of the top management team to manage diversification is limited by the dominant logic(s) it possesses. Prahalad and Bettis (1986) state that "if the businesses in a diversified firm are strategically similar, one general dominant management logic would suffice" (p. 490). When businesses are strategically dissimilar, however, more than one dominant logic will be required.

Since multiple dominant logics are hard to acquire and maintain, it is likely that a firm will not have dominant logics readily available to deal with low S-relatedness when it arises. Consequently, managers will be forced to (or will unwittingly) use their existing dominant logic to deal with the low S-relatedness. One implication of this situation manifests itself in corporate performance. Prahalad and Bettis (1986) note:

> A high level of performance in a diversified firm requires the ability to `respond fast' to competitor moves as well as `respond appropriately'. One of the implications of our thesis, so far, is that top managers are less likely to `respond appropriately' to situations where the dominant logic is different, as well as not respond quickly enough, as they may be unable to interpret the meaning of information regarding unfamiliar businesses. The `hidden costs' associated with diversifying into non-familiar businesses . . . are not explicitly recognized when the overall business climate is very favorable. Problems surface when newly acquired businesses (which are strategically dissimilar) encounter competitive problems or are faced with a profit crisis. Top managers find themselves unable to respond to the crisis under those circumstances (Hamermesh, 1977, p. 497).

S-relatedness Dimension

Unlike a firm's position in the R-relatedness dimension which is categorical, a firm's position in the S-relatedness dimension is relative. That is, a firm may have either a higher level of S-relatedness or a lower level of S-relatedness when compared to other firms. This can be illustrated using the Miles and Snow (1978) typology. If a corporation pursues an S-related strategy, its business units could all be classified as the same strategic type, for example, defenders. The firm would be considered to have high S-relatedness. If, on the other hand, a firm pursues a diversification strategy that results in different strategic types across business units it would exhibit relatively low S-relatedness. Its business units would be classified in more than one type, for example, defenders and prospectors. In this situation, the firm would be considered less S-related than the firm in the first example.

HYPOTHESIS

The choice of merger and acquisition partners determines a corporation's level of S-relatedness because it affects the degree of strategic similarity among business units within the firm. Since a change in dominant logic(s) is slow and difficult, this precludes either the development of a new dominant logic by the acquiring firm or the changing of the acquired firm's dominant logic in the short run. A relatively low level of S-relatedness imposes significant costs upon a firm and those costs will negatively affect corporate performance. The performance of a diversified firm, then, is dependant on its level of S-relatedness. This brings to mind several questions. This paper will deal with the most fundamental question of the relationship between diversity and performance.

Hypothesis: The performance of a diversified firm is independent of its level of S-relatedness.

This hypothesis is designed to test for a significant relationship between the level of S-relatedness and corporate performance. Firms with relatively higher levels of S-relatedness should outperform firms with relatively lower levels of S-relatedness because there are fewer costs associated with high S-relatedness.

INDEPENDENT VARIABLES

The independent variables are measures of business level strategy. There have been several alternate approaches used to measure business level strategy. An early approach was the narrative approach that evolved from the case-based tradition of business policy. Proponents of this approach argue that each strategy is unique and so it is best described in a narrative fashion. Any attempt to develop a measurement scheme would be incomplete. While this view has merit, especially in conceptual development, it is ill suited for testing theories (Venkatraman, 1989).

A second approach is the classificatory approach. This approach consists of the development of strategic classifications, either typologies or taxonomies. Classifications that are inductively derived are termed typologies. Among the prominent alternatives is the classification scheme developed by Miles and Snow (1978). Venkatraman (1989) notes that the distinguishing feature of such typologies is that they:

> are rooted in a set of parsimonious classificatory dimensions or conceptual criteria. While typologies are best known for their conceptual elegance, they do suffer from an inherent weakness in that it is fairly easy to find a single dimension on which a typology can be based and which will . . . support any given philosophical orientation (p. 493).

Taxonomies, on the other hand, are empirical classifications. Some prominent taxonomies include Miller and Friesen (1978) and Galbraith and Schendel (1983). While taxonomies reflect the empirical existence of internally consistent groups, their development is sensitive to the choice of underlying dimensions and the methodology used to construct the taxonomies (Venkatraman 1989).

A third approach to measuring strategy is the comparative approach. This approach aims to measure key dimensions of the strategy construct. Snow and Hambrick (1980) have said that "researchers can enhance the validity of their strategy measures if they rely on multiple sources of information" (p. 537). Further, Hambrick (1980) notes that "a multivariate analysis is most useful when strategy is viewed as a predictor construct in a research design" (p. 571).

The comparative approach was chosen for this research project as a means of measuring business level strategy. This approach assumes that strategy is a multi-dimensional construct. Dimensionality can be arrived at in one of two ways. One is based on a priori theoretical perspectives to guide construct development. This approach was chosen for use in this paper. The other approach is to derive dimensions a posteriori through analytical techniques such as factor analysis. The danger in using this approach is that any dimensions derived through data analytic techniques may not be interpretable given the theoretical perspective of the study (Venkatraman, 1989).

Resource allocation variables were chosen to measure a business unit's strategy. Resource allocation measures have been widely used by strategic management researchers as a comparative approach to operationalizing business level strategy (see Harrison, Hitt, Hoskisson, & Ireland, 1991). To enhance construct validity, several steps were taken in the selection of these variables. First, they had to adhere to Beard and Dess's (1981) four criteria. These criteria are to be used when selecting resource allocation variables to represent business level strategy. The criteria are: first, that a variable should confer a competitive advantage or disadvantage upon a firm; second, the data on the variables must be available for both firms and industries in secondary data sources; third, the variable must be amenable to management control; and forth, the variables must be characteristic of the organization as a whole and be observable across organizations in a given industry. Every effort was made to ensure that the resource allocation variables chosen for this study adhered to these criteria.

The second step was that, as far as possible, the resource allocation variables had to be used in previous research. Five of the nine variables used in this dissertation including firm asset size, capital intensity, administrative (selling, general, and administrative) intensity, interest intensity, and debt to equity, have been widely used as resource allocation variables in empirical studies to measure business level strategy (see Beard and Dess, 1981; Harrison et al., 1991). Intensity was measured similarly for all variables. It was calculated by dividing the dollar amount of expenditures by total revenues. Even though no previous researcher has included all five variables in a single study, each has been used in at least one study. The other four variables used in this paper meet the Beard and Dess's (1981) criteria but there is no indication that they have been utilized in previous studies. The last step was to choose variables to represent as many of the six strategic dimensions identified by Venkatraman (1989) as possible. Nine variables were chosen to measure a business unit's strategy. The nine variables are: firm asset size, capital intensity, administrative intensity, interest intensity, debt to equity, sales to net working capital, sales to inventory, cost of goods sold to sales, and total assets to current assets.

DEPENDANT VARIABLE

The dependant variable is corporate performance. The treatment of performance in research settings is perhaps one of the most difficult issues confronting strategic management researchers (Venkatraman & Ramanujam, 1986). Unfortunately, the option of ignoring the definition and measurement of performance in this study is not a viable one.

Most research into the performance of diversified firms has used financial indicators. Operational measures have not been widely used because they are more correctly applied to business unit performance rather than corporate performance. For example, market share (an operational measure) among diversified firms is hardly comparable because each firm's configuration of business units is different. This paper must therefore rely on financial indicators to measure a diversified firm's performance.

Return on assets (ROA) has been one of the most popular financial indicators used by researchers to measure a diversified firm's performance. It was the sole measure used by Bettis (1981), Bettis and Hall (1982), Hoskisson (1987), and Grant, Jammine, & Thomas (1988). In addition, Montgomery (1985), Christensen and Montgomery (1981), Hopkins (1987), and Barton (1988) all included this as one of their performance measures. Other measures such as return on invested capital, return on equity and return on sales have been used as performance measures. Also, measures that assess growth rates rather than actual levels of activity have been used by Palepu (1985), Varadarajan and Ramanujam (1987), Christensen and Montgomery (1981) and Hopkins (1987). Heeding Venkatraman and Ramanujam's (1986) concern that financial indicators (such as income growth and ROI) reflect different dimensions and thus cannot be combined into one composite dimension, this paper proposes the use of a single financial indicator to measure the performance of diversified firms. This single financial indicator will be return on assets (ROA).

ROA, as well as all other data for this study was obtained from the COMPUSTAT PC database. This database has been complied in such a way as to minimize the problems associated with the computation of financial measures. For a fuller account of the procedures used in compiling the COMPUSTAT PC database, readers are directed to the lengthy discussion included in the COMPUSTAT PC documentation. While not all problems with data collection and measurement can be overcome, the efforts by the CompuStat PC staff to minimize problems specific to financial measures makes the use of ROA as a measure of firm performance acceptable.

Sample

The sample for this study was drawn from a list compiled by Harrison et al. (1991). The list was formed from the merger and acquisition pool of Standard and Poor's COMPUSTAT research database. This file, as reported by Harrison et al. (1991):

> . . . contains annual financial statement data for approximately 2000 firms that have been acquired in the past twenty years. These firms were then matched to their acquires using Moody's Industrial Manual and the Large Merger Series

> published by the Federal Trade Commission. Approximately 1,100 acquired firms were matched successfully to companies that are also found in the COMPUSTAT database (p. 180).

The period of time covered by the Harrison et al. (1991) list spans the years 1970 to 1989. Because of the need to compare the strategy of the acquiring and the acquired firm prior to the merger or acquisition and also the need to examine corporate performance after the merger or acquisition, data for this study could only be acquired for the fifteen year period from 1973 to 1988. In addition to this constraint, two other important factors limited the sample size. One factor was that resource allocation data for firms engaged in the production of a service (rather than production of a product) was problematic or impossible to obtain. The other factor was that matching data for each of the nine resource allocation variables was not always available, even for firms engaged in the production of a product. This was due primarily to differences in the way firms report financial data. When there was not a specific match in any one of the resource allocation variables, the firm was disqualified. This fact also constrained the number of firms that could be included in the sample. Sufficient data were found, however, to allow the comparison of one hundred and eleven sets of firms.

A proportional absolute difference score (PADS) was calculated to measure the similarity in strategy between the acquiring and acquired firm. The PADS score was calculated using the following formula:

$$(V_{ai} - V_{bi}) / [(V_{ai} + V_{bi}) / 2] = PADS$$

where a = the acquired firm
b = the acquiring firm
i = nth (1-9) strategy variable
V = Firm strategy variable divided by the average industry value for that variable

The proportional absolute difference score yields a standardized difference in the level of resource allocation between the acquiring and acquired firm. This difference score represents the degree of similarity between the two firms with respect to each independent variable. The proportional absolute difference scores for all nine independent variables represent the degree of similarity between the strategies of the acquired and acquiring firms.

Values for each of the nine resource allocation variables were obtained by averaging the three years of data just prior to, but excluding, the merger year. Although a longer period of time might have provided a more accurate measurement of the strategy being pursued by a business unit, each additional year of data would have resulted in the elimination of firms from the sample. In an attempt to determine how much difference additional years of data would have made on the calculations, a sample of firms associated with five years of data prior to the merger was identified. The size of the test sample was eleven or approximately ten percent of the total sample size. The average value for each of the resource allocation variables was figured for five years and compared to the three year average. There was no significant statistical difference between the two sets of averages. With this in mind, it was decided that a larger sample size was preferable to more years of data when calculating the value for each of the resource allocation variables.

Researchers have noted that industry effects, rather than relatedness, may have accounted for Rumelt's (1974) findings (Christensen & Montgomery, 1981; Bettis & Hall, 1982). In order to control for industry effects, the corresponding average industry value for each of the resource allocation variables was also calculated. Each of the nine resource allocation variables were then divided by the appropriate industry resource allocation value. This resulting value became the resource allocation measure that was used to calculate the PADS score.

A percentage change in the acquiring firm's return on assets was calculated. This calculation was made by taking a three year average of the firm's return on assets before the merger and then calculating the percentage change to the post merger three year average return on assets. Adding years to the calculation would have increased the probability that the positive effects on corporate performance caused by S-related diversification would be confounded by other events. Moreover, each additional year would have eliminated recent acquisitions for lack of data. Three years represented a trade-off between these factors (Harrison et al., 1991).

The hypothesis was tested using multiple regression analysis. The proportional absolute difference scores (PADS) were regressed against the percentage change in ROA to test this hypothesis. The PADS scores represent the level of similarity between the business unit strategies of the acquiring and the acquired firm. A lower PADS score connotes a higher level of similarity between strategies. The expectation is that lower PADS scores will be associated with higher levels of performance. Support for this hypothesis will be found if there is a significant inverse relationship between the PADS scores and performance.

RESULTS

Stated in the null, the hypothesis proposes that the level of S-relatedness makes no difference to a corporation's performance. One assumption of multiple regression is that the relationship among variables is linear. To check for linearity of data, multiple regression equations were also run using the logarithmic, square, and square root transformations of the independent variables' PADS scores. The transformations resulted in models that were not as accurate in predicting post-merger corporate performance. Test results for the hypothesis are shown in Table One. Data presented in Table One indicate qualified support for the alternate hypothesis. The R^2 statistic at .1864 was statically significant and at approximately the same level as achieved by other researchers (Rumelt, 1974 & 1982; Harrison et al., 1991).

Table One
Multiple Regression of Resource Allocation Variables

on Post Acquisition Performance Analysis of Variance Report					
Dependant Variable: ROA					
Source	df	Sums of Squares (Sequential)	Mean Square	F-Ratio	Prob
Constant	1	10.22573	10.22573		
Model	9	233.1097	25.90108	5.02	0.000
Error	197	1017.398	5.164457		
Total	206	1250.508	6.070427		
Root Mean Square Error 2.272544 Mean of Dependant variable -.2222604 Coefficient of Variation -10.22469 R-Squared 0.1864 n 208					

Table Two provides data on the beta coefficients for each of the independent variables. These data reveal that changes in the independent variables resulted in change in the dependent variable in the expected direction. That is, a negative beta coefficient sign indicates that as the value for the independent variable increases (in this case, that value represents an increase in strategic dissimilarity) the value of the dependant variable decreases. This finding lends support to the theory that, as the strategies of business units become increasingly different, corporate return on assets decrease.

Table Two Multiple Regression of Resource Allocation Variables on Post Acquisition Performance							
Multiple Regression Report							
IndepntVariable	P'meter Est.	Stdzed Est	Stnd. Error	t-value 1 tail	Prob. Level	Seq R-Sqr	Simple R-Sqr
Intercept -.57886 0.0000 .36752 -1.58 0.0585							
C2	-.187E-01	-0.0036	.35767	-0.05	0.0092	0.0009	0.0009
C3	-.9803011	0.1674	.41791	2.35	0.0100	0.0152	0.0151
C4	-1.60182	-0.1827	.63559	-2.52	0.0063	0.0220	0.00

C5	-.596E-04	-0.0451	.86E-04	-0.69	0.2451	0.0224	0.0007
C6	-.190E-04	-0.0112	.11E-03	-0.17	0.0323	0.0227	0.0000
C7	-.6237794	-0.3934	.10584	5.89	0.0000	0.1422	0.1060
C8	-.6459073	-0.0968	.49682	-1.30	0.0976	0.1424	0.0002
C9	.7140135	0.1502	.37032	1.93	0.0277	0.1579	0.0080
C10	-.8326104	0.1852	.31706	2.63	0.0047	0.1864	0.0079

An examination of the beta coefficient signs in Table Two reveals that the only positive sign is for variable C9 (cost of goods sold intensity). Obviously, when an increase in the dissimilarity of strategies affects performance in a positive rather than negative way, there is some cause for concern given the theory developed by this paper. A possible explanation for this result is that cost of goods sold intensity could be co-linear with another variable and Pedhazur (1982) notes that multicollinearity can cause a reversal in signs.

To summarize, similarity between the business level strategies of the acquired firm and the acquiring firm was positively related to post merger performance of the acquiring firm. This finding is important in two ways. First, it supports the commonly held notion that relatedness is an important variable in understanding performance differences among diversified firms. Second, and perhaps more important, it demonstrates support for the notion that relatedness can be conceived of in more than one way. The addition of another relatedness dimension raises significant research questions.

DISCUSSION

The premise of the hypothesis is that the degree of strategic similarity among corporate business units determines, in part, corporate performance. Specifically, the greater the degree of strategic similarity among business units, the better is the corporate performance. This hypothesis was conditionally supported by the data.

One important implication of this finding concerns the use of R-relatedness as a research perspective when investigating corporate diversification strategy and its effect on corporate performance. It is possible that the concept of relatedness, as used in this context, is multi rather than unidimensional. Because of this, researchers using a relatedness perspective in their investigations may have to take this multidimensionality into account.

Another implication focuses on the inconsistent results obtained through use of the R-relatedness perspective. Currently, there are two seemingly unreconcilable positions that have emerged in the literature. These are either that R-related diversification leads to superior performance when compared with R-unrelated diversification or that superior performance can be achieved using either strategy. The notion of S-relatedness has been used to reconcile these two positions. Based on the theoretical argument presented in this paper, superior performance can be achieved by either an R-related or R-unrelated strategy contingent upon the level of a firm's S-relatedness.

CONCLUSION

The findings are encouraging enough to warrant further research. This conclusion is drawn despite the fact that there has been a great deal of research into the question of variation in corporate performance resulting from different corporate level strategies. While the nature of a corporation's business units' relatedness has been a focus of strategic management research into corporate diversity, relatedness has always been assumed to be the single R-related dimension. This study has demonstrated that relatedness may be conceived of in more than one dimension.

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LEARNING ORGANIZATIONS: PANACEA OR PARTIAL ANSWER?

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ABSTRACT

It has been argued that an effective coping mechanism, indeed a strategy, for addressing the uncertainties of the new century is for businesses to become learning organizations; however, it is not entirely clear that becoming a learning organization guarantees or even correlates with successful performance in the marketplace. Thus, there are three purposes for this paper. First, we will attempt to define a "learning" organization. Second, we will *address the behavior, practices and tactics of learning organizations and how some of these learning attributes may distinguish learning organizations from other types of organizations. Third we will attempt to answer the question posed in the title of this paper, "Is becoming a learning organization a panacea or a partial response to the demands of the 21st century?*

INTRODUCTION

To understand the effects of a learning organization on performance, a basic, comprehensive understanding of learning organizations is necessary. A learning organization as an organization continuously testing experiences, transforming those experiences into knowledge relevant to the company's core purpose and making that knowledge accessible to the entire organization (Senge, 1994). It is a long-term activity designed to build a competitive advantage over time and as such, requires sustained management attention, commitment, and effort. Companies recognized as learning organizations today include Motorola, Wal-Mart, British Petroleum (BP), Xerox, Shell, Analog Devices, GE, 3M, Honda, Sony, Nortel, Harley-Davidson, Coming, Kodak, and Chaparral Steel (Goh, 1998).

LEARNING ORGANIZATIONS FURTHER DEFINED

David Garvin defined a learning organization as an organization skilled at creating, acquiring and transferring knowledge, and the action of modifying its behavior to reflect the knowledge gained (Garvin, 1994). Looking closer at this definition, it is obvious that the development and sharing of knowledge are basic tenets of a learning organization. Given this fact, two questions come to mind. The first of which is "Don't all organizations seek to learn and gain from the knowledge they acquired," and if they do, "Why aren't all organizations considered learning organizations?" To answer the first question, yes, all organizations wanting to stay competitive should be attempting to learn and change based on the knowledge gained. However, not all organizations are learning organizations. This is further explained by studying the characteristics of learning organizations.

CHARACTERISTICS OF LEARNING ORGANIZATIONS

Five activities form the "building blocks" of an effective learning organization. These building blocks are: (1) systematic problem solving, (2) experimentation with new approaches, (3) learning from your own experiences and past history, (4) learning from the experiences and best practices of others, and (5) transferring knowledge quickly and efficiently throughout an organization. Each of these blocks is accompanied by a unique mind-set, pattern of behavior, and certain tools for implementation (Garvin, 1994).

Systematic problem solving, the first building block, is based on the ideals and methodology of quality. The core competencies of this block include the use of a scientific method to diagnose problems, use of verifiable data to support decision making, and utilization of simple statistical tools such as histograms, pareto charts, and cause-and-effect diagrams to organize data and draw conclusions. Xerox, for example, is one company that has mastered this activity through a 6-step problem solving process throughout its organization (Garvin, 1994).

The second building block is experimentation, which entails systematically searching for new knowledge and then testing that particular knowledge. Experimentation, like problem solving, is based on a scientific method; but unlike problem solving, which is driven by existing problems, experimentation is driven by perceived opportunities and expanding horizons. One form of experimentation is described as ongoing projects. Ongoing projects utilize a continuing series of small experiments to produce incremental gains in knowledge. Allegheny Luellum, a specialty steel maker, regularly experiments with new rolling methods and improved technology to improve quality and reduce costs within the organization. Another form of experimentation is the demonstration project. Demonstration projects are usually larger and more complex than ongoing projects. They take a holistic approach to system wide changes, often exploiting a single site or process to develop new capabilities for the organization (Garvin, 1994).

The ability to learn from past experiences is the third building block. Businesses must assess previous successes and failures in order to capitalize on the knowledge gained. However, for this to be effective, managers must maintain objectivity during the review process. Previous failures need to be viewed as learning experiences, not criticisms of past or present management techniques. Boeing Aerospace is one company that learns from hard times and capitalizes on them. After experiencing difficulties with the 737 and 747 aircraft programs Boeing initiated Project Homework. Project Homework consisted of a group of high-level employees who examined the 707 and 727 programs, which are the two most successful programs to date. The group then compared their findings to the 737 and 747 programs. The objective was to develop a set of lessons learned for future implementation. Boeing, guided by experience and knowledge, then produced the 757 and 767 aircrafts, which are the most successful and error-free programs in the company's history (Garvin, 1994).

Learning from the for-tunes or misfortunes of others is equally as important at learning from one's own successes or failures. One method of accomplishing this fourth building block is through benchmarking. Companies who seek to benchmark get their best results by copying the practices and methods of other successful business activities, rather than focusing on particular results. By focusing on methods rather than results, any selected activity can be benchmarked. However, learning from others should not be limited to benchmarking. For example, at the Worthington Steel Company, all machine operators make periodic, unescorted trips to their customer's factories to discuss their changing wants and needs (Garvin, 1994).

The final building block, which is the most important to the validity of the hypothesis, is how knowledge is transferred. The transfer of knowledge throughout organizations must be quick and efficient. A variety of methods, each with its own strengths and weaknesses, can be used to facilitate the transfer of knowledge. These methods include written, oral, and visual reports, site visits and tours, personnel rotation programs, and education and training programs.

Reports offer the greatest flexibility because they serve a variety of purposes. Reports can be brief, providing only summary data or they can be extremely explicit providing a detailed analysis. Flexibility is one reason why reports are the most popular knowledge transfer medium. Tours are equally as popular. They are especially practical for transferring knowledge to large, multi-divisional, multi-site organizations. However, tours are most effective when they are tailored to meet the needs of a specific audience. One example of this can be found at New United Motor Manufacturing Incorporated. (NUMMI). In its partnership with Toyota, General Motors developed a series of specialized tours, some geared towards upper and middle management, while others were designed for lower-level employees. Another method of actively transferring knowledge is through the use of personnel rotation programs. Every organization has individuals who are recognized as the experts of a particular activity or process. By moving their experience into different positions within the company, the knowledge they possess is shared by many. Transfer programs can be used to transfer employees between departments, between facilities, and may even involve senior, middle, or first level managers in line to staff transfers. Education and training programs are also powerful tools for knowledge transfer. An important factor to remember when using training and education programs is to follow-up after training. Frequently, management assumes that the knowledge gained during training sessions will automatically be implemented. In reality, without proper follow-up, this assumption can result in flawed management perspectives and faulty decisions (Garvin, 1994).

CHANGE

In addition to understanding what learning organizations are, an understanding of change is necessary to explore our tentative proposition regarding the efficacy of learning organizations. In an environment of organizational change, employees frequently want to know one thing, "Why do we have to change?" Management not only needs to address that topic, but two others, as well. Management must find the optimal way to implement change in an organization with the minimum amount of traumatic impact. Finally, top management needs to understand why employees resist change.

Why Businesses Change

Contrary to some teachings, change for the sake of change is not always favorable for all involved. Psychologists acknowledge a natural human tendency to resist change. So, if we are naturally resistant to change, why do it? The answer is simple--survival. In business, like society, when change becomes necessary to survive, individuals must overcome their resistance mechanisms (De Geus, 1998). Klunk (1997) reinforces the reason change is necessary for the survival of businesses by saying, "Competition in today's world is fierce. Organizations are restructuring, re-engineering, acquiring, merging, tightening their belts, downsizing, transforming their cultures, and raising their expectations. Those organizations that refuse to change or change too slowly will not survive."

Charles Handy (1995) states that one set of forces push toward tight control and central decision making while at the same time there are many attractions and valid reasons for doing just the opposite, decentralizing and delegating. The forces to make organizations more orderly and formal are convincing, but so are the opposing forces to recognize the individuals who make up the organization and the pressing need to give them more scope and independence. An increasingly more individualistic workforce born of a richer and freer society will result in new varieties of organizations, new structures, and new ways of relating individuals to organizations. Handy (1995) posits that three fundamental forces, operating in concert, are cultivating the imperatives for organizational change: (1) overly complex systems, (2) extreme specialization of work roles, and (3) new values and norms. The research of John Child (1 972) shows that as total size increases in fast growing large companies, so do certain types of systems and procedures enacted to enhance control and consistency. The complex systems demanded by largeness achieve consistency and profitability, as long as the work process is routine, the environment stable, and change infrequent. Unfortunately, with the emergence of global competition, our business environment has seen a dramatic increase in the magnitude, nature, and frequency of change. The implication for large organizations with complex systems is that they will be less responsive to the environment, less able to change, and less in control of their destiny. For example, the "old" IBM under the leadership of John Ackers experienced bureaucratic breakdown as a consequence of its excessively complex, centrally controlled systems.

The second force, extreme specialization of work roles, deprives workers control over their destiny and is alienating. The emphasis on work roles, as distinct from the individual, precludes the individual's ability to express his/her values and personalities within the work performed. As expressed by Adam Smith (1776), "The man whose life is spent in performing simple operations ... has no occasion to exert his understanding. He generally becomes as stupid and ignorant as it is possible for a human creature to become." Thus, the individual becomes a role more than a person, initiative comes from above, not from within, and creativity is seen as an organizational disruption.

The third force, new values and norms, springs from a generation reared in a freer, more affluent society bereft of major wars. David Yankelovitch's (1972) survey of the changing views of American students found an increasing resistance to authority. He concluded that the single greatest erosion of relationship to authority was in the "boss" relationship. Over a four year period, the percentage who did not mind the future prospect of being bossed around on the job fell from 56% in 1968, to 49% in 1969, to 43% in 1970, and further to 36% in 1971. Considering that this data is nearly three decades old, it is reasonable to conjecture that a student's relationship to authority has gone from grudging acceptance to tacit defiance. In response, organizations have begun to change. Treating people as individuals rather than human resources has required a structural transformation. Increasingly, organizations are adopting a more professional type of organizational form in which each individual is qualified and certified, there are few levels of authority, and the organization is run by consent rather than decree. Additionally, to avoid the liability of bigness, organizations have kept their operating units as small and as autonomous as possible without losing the advantages of scope. Terming this kind of organizational form an adhocracy, Henry Mintzberg (1983) describes it as a: "Highly organic structure, with little formalization of behavior, high horizontal job specialization, based on formal training; a tendency to group specialists in functional units for housekeeping purposes, but to deploy them in small market-based project teams to do their work."

It is inevitable, organizations must change. The topic that becomes important is how management can implement changes while minimizing their impact on the organization.

Implementing Change

Peter Senge (1994) states that, "when people truly share a vision, they are connected, bound together by a common aspiration. In the absence of a great dream, pettiness prevails." Mindful of this, management must share its vision for the future with the rest of the organization. In addition to communicating visions, management can educate employees and teams, providing them with the tools to manage change, deal with stress, and resolve conflict constructively. Training programs can be used to coach employees in methods to recognize the implications of change, deal with the inevitable resistance, and build personal strengths and assets throughout the process (Klunk, 1997). Communication and education are only two of the activities essential to coping with change in an organization. Actual change implementation procedures vary according to the size and structure of the company. However, no change implementation plan will be totally effective without understanding the effects of change and why employees resist change.

Effects of Change

Most organizations fail to understand the stress associated with change. Change can be unsettling and chaotic. It can result in stress and conflict for employees. When mismanaged or ignored, it can destroy the loyalty and spirit of even the best companies. Researchers have found that U.S. employers spend $150-$200 billion annually on stress. Forty-four percent of office workers feel that their stress has worsened in the past two years, fifty-two percent of Americans identified the workplace as the leading cause of stress in their lives. To greater emphasize the stress attributable to the workplace, one out of five workers worldwide admitted to absenteeism caused by work related stress (Pritchett & Pound, 1994).

Why Employees Resist Change

Strebel (1996) describes personal compacts between organizations and their employees. These compacts are described as reciprocal obligations and mutual commitments, both stated and applied that define the relationship. Three major dimensions of a personal compact were identified as (1) the formal dimension, (2) the psychological dimension, and (3) the social dimension.

The formal dimension is the most familiar and structured element of a compact. Job descriptions, employed contracts, performance agreements, and performance evaluations are included in this type of dimension. Although it is not always perceived as such, the formal dimension is closely related to both the physiological and social dimensions (Strebel, 1996).

The physiological dimension is comprised of the implicit aspects of the employment relationship, including intangible assets such as trust, commitment, and the interdependence between an employer and an employee. This dimension is usually characterized by the relationship of an employee with his/her boss. A manager's ability to understand and manage this dimension of the compact is essential to reduce internal conflicts and insuring employee commitment during times of change (Strebel, 1996).

The social dimension is the final dimension of a personal compact. In this dimension, employees compare what the company's mission statement depicts as its values with the actual practices and corporate attitudes of the company. Closely related to the formal dimension, the social dimension examines the informal hierarchy within a business (Strebel, 1996).

Each dimension of the compact requires an exchange of trust. For example, an employee does not expect to perform duties not included within his/her job description. Likewise, an employer does expect his/her employees to perform those tasks that are included in the job description. Any disruption of the trust that results from the reciprocating effects of these dimensions can be detrimental to the everyday operation of a business. During periods of change, the effects can be devastating.

There are several reasons why employees resist change. Acknowledging that resistance to change is natural and that corporate culture plays a significant role in determining how change is received only begins to explain the effects of change in an organization. Nevertheless, with these rudimentary understandings of learning organizations and the effects of change, it is now possible to determine the plausibility of the hypothesis.

CONFLICTING ARGUMENTS

Arguments for rejecting our tentative proposition include an article refuting the existence of learning organizations and an article purporting learning organizations as scams. James Belasco simply believes that learning organizations do not exist. He compares the sightings of learning organizations to sightings of UFOS. There are occasional sightings, but before hard evidence can be obtained, they disappear in the light of day. Belasco believes that organizations don't learn, people learn. "You can have a collection of learners in an organization, but you can't have a collection of organizations that learn" (Belasco, 1998) With this belief, Belasco advocates three ideas for helping people to learn: (1) Get serious about top financial returns by investing in learning, (2) Build on-the-job learning experiences, and (3) Become a coach/vehicle for other peoples learning (Belasco, 1998). The idea that corporations do not learn and that people do is semantically correct. Even though this author promotes the idea of learning, he disputes the existence of learning organizations.

Another view, advocated the position that the "ruling class" will retain the lions' share of power and control over resources, information, and learning opportunities. The author believes "that the notion of a learning organization may even be turned to ideological use. In doing this, non-learning organizations would be forced to believe that they have less power than they actually do" (Coopey, 1995).

The final argument disputing the proposition deals with personnel rotation programs used by many corporations. From previous experience, it is noted that rotation programs can induce, rather than reduce stress among employees. The military is a good example of this argument. For instance, junior enlisted members do rotate between jobs; however, senior enlisted and officers rotate far more frequently. This can result in stress for the junior enlisted who must learn the expectations of new management approximately every 12-18 months. While the goals and mission statements of the organization seldom changes, the management techniques used to achieve those goals do change and result in additional stress.

SUPPORTING ARGUMENTS

Everyone is familiar with the idea that knowledge is power. When an organization transfers and shares knowledge it is also empowering its employees. Not every employee will understand or support changes, especially changes that involve workforce reductions; however, by providing all employees with the same knowledge, rumors can be expunged.

With the common presence of organizational downsizing, outsourcing, divestiture, and retrenchment, it signals a fundamental change in the way businesses operate. Responding to competitive requirements for speed, market pressures for flexibility, workforce demands for more scope and independence, and opportunities inherent in digital technology, organizations are developing new ways of relating individuals to organizations. To accomplish this, leaders have to furnish organizational members with direct access to information that was once the province of executive decision-makers. All organizational members must intimately understand an organization's context, problems, opportunities, vision, values, and strategy more completely than ever before. It appears that because of organizational changes taking place and advancements in information technology, the traditional way of organizing work is a social artifact that has outlived its usefulness (Bridges, 1994). Therefore, the challenge now is how to realistically prepare for the realities of a fundamentally different business milieu.

Technology

Digital technology, particularly the Internet, is transforming the way businesses operate and is a formidable facilitator of structural change. The internet is a network of computer networks that allows access to numerous existing information sources. While no files or databases actually reside on the interact, it does serve as a path to existing information sources. General online services such as America On-Line, Compuserve, and Prodigy provide subscribers access to a wide array of information and the ability to shop in electronic malls. Professional online services such as Dow Jones News/Retrieval and Dialog provide industry specific information and access to other commercial databases. In addition, internal networks (intranets) serve the internal information needs of an organization by accessing and sharing operational data.

Businesses have begun to capitalize on the capabilities of the internet in a variety of ways. For some companies the internet has become a powerful marketing tool allowing the company to sell its goods and services without having to employ a direct sales force. For example, Amazon.com, the most popular bookstore on the net, draws in hundreds of thousands of visitors each day to browse their selection of 1. 1 million books (Rebello, 1996a). Customers who log on and complete a profile are e-mailed timely information about new books in print on their favorite topics or by their favorite authors. Amazon's founder, Jeff Bezos, is also setting up forums where readers and authors can interact and chat lines for literary interest groups. Amazon's use of digital technology as the core of their marketing strategy has permitted them to compete effectively with such megastore chains as Barnes & Noble. Eastern Meat Farms has also expanded their business through the internet (Rebello, 1996b). Owners Richard Lodico and Vinny Barbieri offer to ship pastas, cheeses, meats, and breads anywhere at their web site, Salami.com. While it is a real moneymaker and has expanded their geographic scope of operations, they credit their "cyber success" to the same principle applied in their store--first class customer service.

The opportunity to expand market reach via digital technology also holds implications for the internal operations of the firm. In 1994, publishing giant Simon & Schuster set an ambitious goal of generating half of their revenues from electronic publishing by the year 2000 (Verity, 1996a). To cope with formidable demands of managing a multitude of graphics, video clips, audio files, and millions of pages of intellectual property Chairman Jonathan Newcomb ordered a reengineering of Simon & Schuster's editing, production, and accounting processes built around a Corporate Digital Archive. The $750,000 computer system will be the centerpiece of their operations and allow them to use information over and over again. The system will be accessible to editors anywhere for browsing on the company's intranet.

Pushing the boundaries of electronic commerce technology, Wal-Mart and Warner--Lambert (the maker of Listerine) will be demonstrating to retailers and their suppliers a way to save billions of dollars by more accurately forecasting demand for individual products (Verity, 1996b). Currently, Wal-Mart and other retailers do their own forecasting, but share little with their suppliers. Errors of up to 60 percent result, leading retailers to order more than they need and suppliers to produce more than they can sell. Collaborative forecasting and replenishment (CFAR) presents a way for manufacturers and retailers to work together on forecasts across the internet to reduce the estimated $715 billion in idle U.S. consumer goods inventory.

Computer networking may be the most notable development in managing organizations since the modem corporation was invented by Du Pont, General Motors, and others before World War I 1 (Stewart, 1994). Networks connect individuals to individuals and individuals to data. They allow information to flow directly between individuals instead of circulating vertically through the hierarchy. In an interview with Thomas Stewart (1 994, p. 46), Robert Walker, Chief Information Officer of Hewlett- Packard comments: "With the ability to share information broadly and fully without filtering it through a hierarchy, we can manage the way we always wanted to."

Restating the key principle, the transfer of knowledge is essential to both creating an effective learning organization and reducing employee stress. "There is a strong feeling at the leading edge of business thinking that the learning organization is the way forward in these rapidly changing times" (Black & Synan, 1997, pp.70).

CONCLUSION

Although there are non-learning organizations present in the market, the majority of firms will be migrating towards becoming a learning organization-the 21st century demands it. Since the business world is constantly in a state of change, learning organizations are the way of the future. A firm must be able to change with the times and continuously learn in the process.

Management must be willing to commit to learning organizations. They are not created with interoffice memos. This process requires time, support, and nurturing to fully develop. As stated earlier, when an employee loses faith in the employer, the employer's credibility is lost, perhaps forever. Therefore, when a business doesn't adhere to the tenets of learning organizations, they may be producing stress and losing credibility, thereby condemning future change efforts to failure.

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THE IMPACT OF DOWNSIZING

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ABSTRACT

Many businesses have painlessly grow fat over the years, but now are flattening their organization structure through downsizing. Historically, layoffs tended to affect line manufacturing workers, but since the mid-1980s, white-collar and managerial jobs have been hardest hit. Unlike the layoffs of 20 years ago, these cuts are permanent. In addition to causing employees to question their loyalty to their employers, layoffs usually result in demoralized employees fearful of losing their jobs. While downsizing is a short-term money maker, there is little evidence that downsizing is highly effective in boosting profits and productivity. Thus, smart executives are searching for alternatives.

INTRODUCTION

The late 1990s will be viewed as the era of America's downsizing in the next century. American businesses have been in a period of adjustment of organizational structure in recent years ranging from modest to dramatic. Some of these changes have resulted in elimination of layers of management. Today's CEO typically holds the view that there are too many management and support positions performing tasks of questionable value. But how did the organization get to that point?

Management layers and functions are usually added because there is a claim or evidence that there is more work to be performed or a specific function is desired. Employees are hired in reaction to the perceived expansion of various managers' spans of control. Also, when a business is earning acceptable profits, there is less attention given to cost-benefit analysis to determine if more employees are needed. There is a tendency to avoid asking what is the true value of this position to the ultimate customer when the business can afford it.

Today's competitive forces prevent organizations from adding positions of questionable value. As competitors trim their workforce through downsizing or, more pleasantly, rightsizing, the drive for more efficient operations becomes more imperative. Companies strive to flatten their organization structure by eliminating management positions as well as first-line employees. In addition to the desire to flatten their organization structure, reasons for layoffs include: corporate mergers and acquisitions, a desire for lean production and fat trimming, the computer performing work of middle managers, and the impact of foreign competition eliminating some jobs. While it may take years of painless effort for a business to grow fat, flattening of the organization occurs abruptly with pain, dismay, fear, and disappointment.

EFFECTS OF DOWNSIZING

Since 1980, U.S. companies have cut more than 43 million jobs through downsizing. That represents layoffs affecting nearly three-quarters of all the U.S. households. Unlike the layoffs of 20 years ago, these cuts are permanent. Historically, layoffs tended to affect line manufacturing workers, but since the mid-1980s, white-collar and managerial jobs have been hardest hit. In the largest U.S. firms, 77 percent of the jobs lost since 1989 have been white-collar jobs (Anfuso, 1996; Laabs, 1996). In fact, the middle management level, comprised of the supervisors of the first-line supervisors, is frequently the most vulnerable to organizational flattening.

Nadler (1998) reported that in April 1998 layoffs were up 38 percent over 1997 levels; the Labor Department indicated that this is a permanent trend because 3.2 percent of permanent workers (those who held their jobs for three years or more) were laid off in 1993 and 1994. In the 90s, white-collar workers made up 60 percent of those laid off while those in goods-producing industries fell to 40 percent of the total.

Job Security

Even in a booming economy, thousands of employees lose their jobs through no fault of their own. John Challenger, executive vice-president of the Chicago-based outplacement firm Challenger, Gray and Christmas, believes that one million jobs will be cut by the year 2000 even if there is no economic downturn (Mikesell, 1998). Challenger, Gray and Christmas also reported that job cuts in November 1997 alone totaled 47,241, a 128 percent over the September 1997 total (Gordon, et al., 1998).

For many years specialization meant job security. For decades an employee who did one thing well could count on steady employment for most of their career. Now, being specialized infers being dependably unchanging and constant which makes one a prime candidate for downsizing. Today's job security lies in versatility, flexibility, and adaptability (McConnell, 1998).

The empirical literature on job tenure suggests that from 1970s to early 1990s, job tenure remained roughly constant. The overall probability of job loss also did not change between the 1970s and the early 1990s. However, there is evidence that over time, there has been a shift in the composition of job separations towards involuntary job loss and away from quits. More recent data show that between 1989 and 1995, job tenure remained constant, but involuntary job loss increased. Involuntary job loss has increased among workers between the ages of 40 and 55, and job tenure has declined for that age group as well (Schmidt & Svorny, 1998).

Reasons For Corporate Downsizing

Corporate downsizings are motivated by two basic reasons: declining sales and a desire to improve efficiency. It is understandable why in a crisis that executives resort to downsizing.

Labor costs are one of the largest expenses, especially in service and knowledge-intensive industries. Thus, downsizing is a short-term money maker. CEOs often reap a quick gain as stock prices frequently go up temporarily after their company announces an upcoming layoff. Wall Street analysts may interpret the downsizing to mean that management is finally intent on creating a turnaround. Layoffs are also a management consultant's dream that can yield them immediate financial results and create other organizational problems. This in turn gives consultants more business with the same client (Dugan, 1996, p. 998).

As a result, there is little evidence that downsizing is highly effective in boosting profits and productivity despite the number of layoffs in the 1990s. An American Management Association survey revealed that only 45 percent of companies that reported a decrease in payrolls reported an increase in operating profits within a year after staff reductions. One-third of the firms said they had experienced gains in worker productivity within a year after the layoff, but employee morale ebbed at these cost-cutting companies (Meyer, 1997). Thus, is "dumbsizing" a more appropriate name because of its impact on esprit de corps?

LONG-TERM PENALTIES OF DOWNSIZING

Organizations may try to generate immediate cost savings by controlling labor cost through downsizing or by paying low wages. However, neither approach is a viable, long-term approach to increase profits, the wealth of the shareholders, or productivity. The increase in short-term profits from downsizing is frequently offset by the long-term penalties of such action.

Stock Price Reactions to Downsizing

Significant negative stock share price reactions are expected when a company announces layoffs and plant closings. Lin & Rozeff (1994) document significantly negative stock returns to layoffs. They theorize that stock price reactions to layoff announcements caused by declining sales will be negative. In contrast, stock price reactions to layoff announcements induced by improving efficiency will be positive.

Sun and Tang (1998) found that not only do layoff announcements affect the stock prices of the announcing firm, but also the stock prices of the firm's industry counterparts are affected. Their sample included 144 downsizing announcements made from January 1982 to December 1990 by 94 firms. The average employment lost per downsizing was 3,540 employees. Because downsizing announcements convey unfavorable information about the general prospects of the industry group, Sun and Tang found a direct relationship between the abnormal returns of announcing firms and their industry counterparts. While the stock price reactions for the 144 portfolios of industry counterparts were not as pronounced as the announcing firms, the abnormal returns were also significantly negative.

Employee Reaction to Downsizing

Retrenchments and downsizing often result in demoralization of the workforce, loss of skilled and experienced workers, disruption of production schedules, and an increased probability of unionization or strikes. Losing skilled workers also results in a higher training cost when hiring new inexperienced employees. Consistent low wages and layoffs create morale and productivity problems. An organization will find it difficult to achieve its goals if the workforce is dissatisfied and/or demoralized. Lower-paid employees will not be motivated to give their best and thus productivity will decline. The organization then suffers constant problems of turnover, absenteeism, and lower productivity. Employees that survive a layoff receive additional tasks, leaving them little time to be creative.

A company cannot keep high productivity and committed employees if at the first sign of bad times, management shows them they are expendable. This causes poor morale among survivors and additional costs arriving from severance pay, accrued vacation and sick-day payouts, outplacement, pension and benefits payoffs, and administrative costs.

Impact on Employee Loyalty

What is the impact of wholesale firings on employee loyalty and morale, and in turn, long-run profits? Intense competition and rapid change are destroying predictability which in the past held an organization together. Virtual organizations and many current managerial practices, such as reengineering, continuous improvement, matrix management, and downsizing, ignore this human need (Stevenson & Moldoveanu, 1995). Having experienced or known the fear of downsizing in the past, employees keep their resumes up to date and their commitments to a minimum.

Certainly, wholesale firings cause employees to question their loyalty to their employers; in the past this loyalty gave American businesses a competitive edge in world markets. Because of downsizing, employees soon realize that loyalty is only one way. Managers stress the importance of them being loyal to their organization, but fail to exercise loyalty in their relationships with employees. The likely result is demoralized employees fearful of losing their jobs.

Traditionally Japanese organizations have differed from American businesses in from approach to downsizing. A productive Japanese employee becomes a part of the company family and receives a life-long job. If an automated process replaces a task, a Japanese company retrains the employee for another task. The result is that Japanese workers view loyalty as a two-way arrangement between their organization and themselves.

Truncated Dismissals

Research has shown that tough times produce tough bosses as downsizing managers often abandon sound management principles. These managers distance themselves from employees and practice truncated dismissals (notification meetings in which managers minimize the time they are in contact with employees). Laid-off employees who resent being treated in this manner often generate ill will in their communities toward former employers. When employees who survive the downsizing learn about this treatment, they often become both scared and angry, which in turns adversely affects their job attitudes and performance.

Folger and Skarlicki (1998) conducted research which investigated the conditions under which managers might be inclined to distance themselves from victims of downsizing. They found that when grounds for criticism are evident--for instance, when mismanagement is cited as leading to a layoff--managers show more tendency to distance themselves from the layoff's victims than they do when external forces cause layoffs. They also found from their research that who made the decision did not significantly affect either the managers' feelings of discomfort or their distancing behavior. Thus, responsibility for deciding who is laid off may be largely irrelevant to distancing.

Managers can minimize these negative effects by demonstrating interpersonal sensitivity. Managers can soften the blow of downsizing by expressing remorse, showing consideration and providing adequate explanations.

ALTERNATIVES TO DOWNSIZING

The evidence that downsizing in itself does not result in a sustained improvement in financial performance and adversely affects a firm's stock market prices should prompt management to seek alternatives to layoffs. Instead of downsizing, there may be other ways to enhance competitiveness by cutting costs elsewhere, introducing new products, or entering new markets. Creating new markets for a company's products and services may expand a company's need for a larger workforce. American businesses need to recognize that continuous improvement efforts are essential to enhancing competitiveness.

Alert to Continuous Improvements

Given a competitive environment, economic theory indicates that continuous employment and high wages can only be paid by innovative firms that are maintaining large market shares because of their product innovations. Because of their increased returns, a company can afford to pay higher wages to attract labor. As these innovative firms find success, others are attracted to the industry. New companies strive to enter the industry and find it possible because few entry barriers usually exist. To continue paying above-average wages, the organization must continue the tradition of innovative advancements and technological expansions.

As the organization becomes larger with more layers of administration, the innovative spirit is difficult to maintain without constant monitoring to ensure continuous improvement. Unfortunately, some managers' reaction to change is not to reengineer the process or product, but to invest even more money in an irrelevant process or product. Indeed, the need for fundamental change is so strong that many organizations need a complete rethinking and reengineering. Merely performing traditional tasks better is inadequate. The current competitive environment requires that managers always be alert to find ways to cut costs and increase productivity.

This was the objective of consultants from Japanese shipyards and Western countries' shipyards who studied the pipe shop of China Shipbuilding Corp. The shop did not meet the shipyard's minimum production requirements, and the shop's competitors provided a higher pipe production rate at a much lower cost. The consultants wanted to determine if it was possible to increase the production rate of the pipe shop with a smaller workforce by combining the kaizen approach and the automation approach into process reengineering. Managers using process reengineering radically rethink a manufacturing process that has existed for many years to reduce costs and improve efficiency and effectiveness. Consultants found the overhead cranes and the bending process in the pipe shop were bottlenecks. The consultants recommended combining both the kaizen approach and the automation approach for process reengineering. They predicted a 50% improvement in labor productivity was possible at the pipe shop with the streamlined manufacturing process. Managers also believe that by enriching jobs, workers would have more pride and responsibility in the proposed new manufacturing process (Lyu, 1996).

High productivity is not typically the result of high wages. Instead, high productivity is the result of technological capabilities and highly motivated employees combined together in an environment which fosters positive feelings and the exhibition of strong work ethics. Relying on economic theory, high wages can only be paid in a competitive environment by innovative firms that are maintaining large market shares because of their product innovations. Laborers can be paid competitive wages during the organization's most successful time. These firms, because of the increased returns possible, can afford to pay higher wages to attract labor. The excessive demand for the product can justify the increased price that occurs as a result. During the time these organizations are successful, they are the industry leaders in innovation and are able to attract management talent. As these innovative firms find success, new firms are attracted to the industry. Competitors make refinements and improvements of the original model by offering similar products or services at lower prices.

Retraining

According to French (1998, p. 307), a growing number of companies are avoiding downsizing through the strategic use of training and retraining. For example, companies such as United Airline, Dial Corporation, and L. L. Bean have made special efforts to reassign and retrain employees for new positions when their jobs are eliminated. This policy is consistent with viewing employees as assets (Sherman et al., 1998, p. 19).

A company should retrain employees for other jobs when automated processes replace their tasks. By matching employees with jobs available internally, a company saves severance costs. Management should give workers the opportunity to learn new skills before firing them. The better approach is for companies to continually offer training to their employees so they can upgrade their skills. They then will be better able to take improved job opportunities as they arise. In addition to retraining when automation replaces 15-year productive employees, there are other solutions that an organization can take. Because productive and loyal employees are hard to replace, such workers should be given the chance to gain new skills and continue to serve their companies.

Smart Cost Reductions

Companies do not throw out equipment when sales get slow so why should they throw out people? Rather than downsize, an organization may try to lower costs by challenging employees to save their jobs by asking them to identify what operations can be changed or what new markets to enter or products or services to introduce. Employees may also agree to small and temporary wage reductions in return for employment security. Other companies reduce labor costs by loaning employees to neighboring companies during slack seasons or offering employee sabbaticals for continuing education. A similar cost-cutting move is to allow people to go on unemployment voluntarily, with a guaranteed return date in a program coordinated with the state. Because age-based mandatory retirement is usually considered unfair discrimination and illegal, employers cannot rely on attrition due to forced retirement as a form of downsizing. However, early retirement program serve as incentives for voluntary attrition *(Business Ethics, 10*).

Job Sharing

Some companies initiate job-sharing programs which involve reducing an individual employee's work week and pay. This approach helps the company cut labor costs and leads to higher overall productivity because each employee is working more concentrated hours. However, expenses per employee may increase because costs of benefits are usually a function of the number of employees, not the number of hours worked or amount of pay. Cost savings, however are often realized through reduced severance pay, unemployment insurance, outplacement, and employee assistance expenses (Schuler, 158).

Preventive Strategies

Just in time cost cutting, hiring freezes, reduced employee hours, time-specific pay reduction, and tying the pay of top-level managers to organizational performance may improve profits enough to avert a layoff. Then management can use this opportunity to re-examine an organization's processes and prepare preventive strategies for the future. By avoiding layoffs, a company retains its highly-trained skilled and productive workers and eliminates the need to spend time and money on recruiting. Also, the frequent result is superior customer service resulting from a loyal and upbeat workforce in addition to reductions in employee turnover and absenteeism. Unfortunately, top management may be reluctant to put themselves at risk by tying their pay to real organizational performance.

Managers should also practice such preventive measures as controlling growth, hiring for tomorrow's criteria, and developing succession plans. They can use outsourcing and employee leasing to fill temporary labor needs. Outsourcing allows an organization to focus on their core competencies and increases an organization's flexibility. Using employee leasing, a company hires a vendor to hire its displaced employees. Even though people are employed by a different company, their jobs and locations stay the same. Employee leasing allows an organization to maintain its working relationships with employees but shifts the administrative costs of health care, retirement, and other benefits to the vendor.

NO-LAYOFF POLICY

Just as manufacturing plant managers are concerned about utilizing their plant assets and avoiding idle capacity, a no-layoff policy encourages top management to keep its income generating resources constantly working. This policy signals to employees that they are an essential investment, rather than an expense. It gives employees security so that they are not uncertain about their future. The result is more productive employees because the company has an incentive to keep its people constantly working. During slow sales, employees are willing to clean plant facilities and repair production machinery. Such actions in turn encourage them to take pride in the plant; they feel ownership of plant facilities.

The high employee morale which usually results from a no-layoff policy helps keep out a union. Further, a no-layoff policy proves a valuable recruiting and retention tool for businesses requiring a highly trained, skilled, and productive workforce in an industry or geographical location where workers are in high demand. In addition, the company does not have to pay the highest wages in its industry. However, if an organization avoids downsizing by consistently paying low wages, then it faces the loss of talented and skilled workers. Given the opportunity, skilled members of the workforce who have mobility will take a better paying job elsewhere.

However, in today's competitive environment, most companies cannot guarantee workers a life-long job. A no-layoff policy is not for all companies, especially those with volatile sales swings or with low-skilled, low-wage employees who can be replaced easily. Also, a written or stated no-layoff policy could create legal problems if terminated employees challenge their dismissal. Possible legal implications and economic and competitive uncertainties strongly suggest that managers should avoid written no-layoff contracts. Because the future is so uncertain, managers must make few promises, but must keep those they do make.

Managers can strongly imply a no-layoff climate by their actions of never laying off anyone and through the other ways they treat workers. To help ease some of the stress, managers should make clear to employees which courses of action will improve their lives so more employees can focus on creating value. It is most important for companies to carefully structure their performance-appraisal and termination procedures. They should spell out those procedures in writing and clearly communicate them before hiring an employee. Managers should monitor operations carefully to avoid reaching a crisis point of full-scale downsizing.

CONCLUSION

Admittedly, downsizing may be the only option open for an organization facing possible bankruptcy. Under these circumstances, survivors may need help to stay focused on performing effectively as employees feel insecure because of the layoffs. If survivors believe that the process used to decide who to let go was fair, their productivity and quality of their job performance may not suffer as much. Certainly, how management handled the termination is important. Providing outplacement services and early retirement opportunities helps relieve some stress.

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