

German Institute for Japanese Studies (DIJ)

**DIJ Business and Economics
Study Group**



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**Market Reactions to Downsizing Announcements –
the Role of Strategy and Knowledge Intensity**

Firms frequently implement employee downsizing as a strategic mechanism to reduce expenses, often sacrificing valuable human capital and triggering negative stock market reactions.

Japanese firms are generally less likely to execute radical downsizing measures. Confronted with legal and societal restrictions to lay off large numbers of employees, they implemented several adaptive downsizing strategies, such as early/voluntary retirement, transfers to subsidiaries (Shukkō/Tenseki), hiring freezes, lay-offs of non-regular employees, and wage-cuts. To get a more nuanced understanding of these adaptive strategies, I collected a unique dataset on corporate downsizing actions from the Nihon Keizai Shimbun (Japan's premier business newspaper) for the time period 2007-2009.

Building on the resource-based view of the firm, I study how these strategic choices affect the likelihood of losing critical organizational knowledge and in turn, how these strategies affect investor response to downsizing announcements. Further, I show that investor response to downsizing strategies is highly contingent on the knowledge intensity of the firm. My results suggest that investors evaluate downsizing announcements only negatively if they threaten the core capabilities of the firm. Investors, however, reward downsizing announcements if the firm is either not strongly dependent on knowledge as a critical resource, or if knowledge dependent firms implement strategies that preserves knowledge.

Daniel Ehnes is currently pursuing a doctoral degree in Business Administration at Goethe University Frankfurt. After studying Economics and Japanese Studies at Erlangen University, which included an exchange year to Yamaguchi University, he obtained his MA degree in Modern East Asian Studies from Goethe University Frankfurt. His research interests include employee downsizing and innovation, with a focus on the Japanese economy.

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