

Alternatives To Organizational Downsizing: A German Case Study

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In the past few years, a new wave of downsizing has been observed. This wave began during the economic recession of the early 1990s and has continued during the subsequent years of economic growth. While the espoused purpose of this wave of downsizing is to reduce costs and increase "competitiveness," empirical research raises doubts about whether these goals have actually been achieved. Downsizing may also have serious negative consequences for the employees who lose their jobs, for their families, and for the employees who survive the restructuring process. Despite these outcomes, downsizing appears to have become institutionalized among executives as a taken-for-granted way of managing organizations. The cognitive rigidity that this suggests makes it important to discuss alternatives to corporate downsizing. The Volkswagen (VW) Company is an important example of such an alternative, because of its innovative policy of preserving employment in Germany. This paper describes the genesis and implementation of that personnel policy, showing that discontinuities in the corporate environment do not always have to be dealt with by means of mass layoffs. Profits and social responsibility do not necessarily have to be competing goals, but can sometimes be jointly accommodated by using appropriate human resource management programs.

INTRODUCTION

The reasons provided for the restructuring of German industry have echoed those offered for restructuring in other advanced industrialized countries. The discourse of "globalization" (Spich, 1995) has provided a rationale for mass downsizing of traditional corporations: the argument is that global competition necessitates continuous cost reduction and productivity increases, and that downsizing is the way to achieve those goals (Jahn, 1995). Despite the absence of compelling empirical evidence that downsizing actually does increase productivity, reduce costs, and enhance profits (Cappelli, Bassi, Katz, Knoke, Osterman, and Useem, 1997; McKinley, Mone, and Barker, 1998), the assumption of the efficiency of downsizing is seldom challenged by managers. In addition, government deregulation, constrained economic growth, and changing consumer preferences are seen as increasing the need for

1. The brands Audi, Seat, and Skoda, and various foreign partnerships with production plants in North and South America, South Africa, and Asia, are also part of the Volkswagen Group. Our analysis, however, focuses only on Volkswagen AG (Germany), the manufacturer of VW cars, with six production facilities in Germany.

intentional workforce reductions and job cuts. Thus, downsizing is also taken for granted as a strategy to deal with economic conditions and regulatory change. The taken-for-grantedness of downsizing (McKinley, Sanchez, and Schick, 1995) is apparent in the comments of corporate CEOs, which increasingly describe downsizing and layoffs as objective necessities beyond their individual control (see, for example, Kleinfeld, 1996).

The purpose of this paper is to present the case of a German company that has resisted the taken-for-grantedness of downsizing, and devised alternative strategies for achieving cost reduction and profitability improvement. The company is Volkswagen AG, and the case described in this paper will draw on a variety of data sources, such as the business press and interviews with members of the works council of VW, to outline what has become known as the "Volkswagen model"¹. We will emphasize the specific context within which the Volkswagen model has been developed, and discuss what other companies can learn from the Volkswagen case. Before describing the Volkswagen case, we will review common explanations for the downsizing phenomenon, and also review the industrial relations and the corporate governance model of German industry, in which Volkswagen is embedded.

While we are sensitive to the limited generalizability of a single case, we believe the Volkswagen story is important for the possibilities it illustrates. The advocates of downsizing programs cannot demonstrate the financial or structural benefits of downsizing (Mentzer, 1996; Cappelli et al., 1997) nor do they respond adequately to the social disadvantages of mass dismissals. Therefore, it is critical to consider alternate routes to the goals of cost reduction, productivity growth, and social welfare. The Volkswagen model represents such a path, suggesting that job preservation and cost savings are not necessarily incompatible.

EXPLANATIONS FOR THE CORPORATE DOWNSIZING PHENOMENON

Current research and theory on the causes of the rapid expansion of downsizing can be summarized in three complementary perspectives: the economic perspective, the institutional perspective, and the socio-cognitive perspective (McKinley, Zhao, and Rust, forthcoming).

The *economic perspective* is the most frequently offered explanation for the great popularity of downsizing. The economic perspective argues that downsizing is motivated by the financial benefits that managers anticipate will flow from it. However, since the majority of studies on the economic effects of downsizing suggest that there is no causal connection between cutting jobs and financial improvement (Cappelli et al., 1997; Cascio, Young, and Morris, 1997), the economic perspective seems insufficient to fully explain downsizing. The lack of demonstrable financial advantages accruing to downsizing has led to

a search for additional reasons that managers might downsize, and has culminated in the development of the institutional perspective (McKinley, Sanchez, and Schick, 1995).

The *institutional perspective* emphasizes the importance of institutional rules. According to institutional theory (Meyer and Rowan, 1977; DiMaggio and Powell, 1983), the social norms of society or of a particular industry define appropriate organization structures and legitimate certain patterns of company behavior. Reduction of uncertainty and the quest for legitimacy are given more weight in the institutional perspective as motives for downsizing than the search for economic efficiency. The central theme of the institutional perspective is that when there are expectations as to what appropriate management is, managers see those expectations as constraints. This effect is sometimes so strong that it seems impossible to those involved to follow any other course of action. According to the institutional perspective, corporate downsizing has taken on the status of an institutional rule (McKinley, Zhao, and Rust, forthcoming). The social forces diffusing this downsizing norm can be metaphorically characterized as "constraining" (a social pressure to engage in a certain course of action), "cloning" (imitation), and "learning" (transmission of a norm within networks of professional exchange) (McKinley, Sanchez, and Schick, 1995).

Lastly, the *sociocognitive perspective* is a theoretical model elaborated to clarify the micro foundations of the institutionalization of downsizing (McKinley, Zhao, and Rust, forthcoming). The fundamental assumption of the sociocognitive perspective is that managers, like other actors, impose schemas onto information domains that need interpretation. One such schema is a template defining downsizing as effective. The sociocognitive perspective argues that this template has evolved from a combination of cognitive simplification processes, ideological influences, and social interaction between managers (McKinley, Zhao, and Rust, forthcoming). The outcome of this complex sociocognitive process is a shared cognitive orientation from which an institutionalized constraint toward downsizing has emerged. This emergence has not been dictated by the financial benefits of downsizing so much as the cognitive order that accompanies adoption of the institutionalized practice. By the end of the process, the collective managerial schema that downsizing is effective has been reified into an institutional rule that seems to exist outside individual human cognition, constraining managerial action toward downsizing.

With the institutional and sociocognitive explanations as a background, we can better understand the spread of corporate downsizing even in the absence of compelling evidence that downsizing is financially efficient. However, these explanations do not challenge the legitimacy of downsizing from a practical point of view, nor do they offer an alternative. Therefore, by describing the case of Volkswagen, we want to open up space for an alternative strategy that goes beyond these three explanations. To understand the Volkswagen case, it is necessary to describe the industrial relations system in Germany first.

LIBERAL MARKET ECONOMY VERSUS SOCIAL MARKET ECONOMY

The development and implementation of the Volkswagen model must be viewed against the background of industrial relations in the German social market economy. The German economic model and its institutions differ somewhat from the liberal market model in the United States (Wever, 1995). The existing economic system in the Federal Republic of Germany is based on the assumption that both shareholders and employees should have the right to influence company policy (Bertelsmann Stiftung and Hans-Böckler-Stiftung, 1998). Co-determination, which is a legally formalized expression of this ethic, is seen as a part of the economic and social order of the Federal Republic of Germany (Streeck, 1992). Co-determination takes the interests of a company's employees into consideration, and therefore modifies corporate policy based purely on maximizing profit. The aim is to recognize profit as a necessary precondition of doing business in a market economy, but scrutinize whether the means of achieving profits are socially acceptable (Steinmann and Scherer, 1999). Therefore corporate governance in Germany can be understood as an applied stakeholder approach (Freeman, 1984) rather than a pure shareholder approach.

Institutionalized co-determination in Germany has enhanced the influence of the employees' interests in managerial decision-making (Wächter, 1983; Streeck, 1992; Bertelsmann Stiftung and Hans-Böckler-Stiftung, 1998). German co-determination laws provide that employee co-determination can be enacted on two different levels: on the enterprise level and on the workplace level. On the enterprise level, representatives of the employees are elected to the supervisory board (*Aufsichtsrat*), which in turn appoints the members of the executive board of management (*Vorstand*) and monitors the policy of the company. However, this law only applies to corporations (joint-stock companies), and its implementation depends on the size and the industry of the corporation (Macharzina, 1995). The *Montanmitbestimmungsgesetz von 1951* applies to corporations in the mining, iron, and steel industries with more than 1000 employees. Here shareholders and employees have the same number of representatives on the supervisory board. The head of the supervisory board, who is an additional individual, has to be a neutral person, i.e. he/she is determined by both sides. The *Betriebsverfassungsgesetz von 1952* applies to corporations from all other industries with more than 500 employees. In this case the representatives of the employees have only one third of the votes on the supervisory board. Finally, the *Mitbestimmungsgesetz von 1976* governs all corporations with over 2000 employees; here the number of the representatives of the shareholders and the employees on the supervisory board is equal. In case of an equal vote the head of the supervisory board, who is elected by the shareholders, will have the final decision.

On the workplace level, the *Betriebsverfassungsgesetz von 1972* provides for the election of works counselors in companies with five or more permanent enfranchised employees. The number of elected works counselors varies with the number of employees in the company. The *Betriebsverfassungsgesetz von 1972* provides for a collaboration between the employer, the counselors, and the trade unions for the welfare of the employees and the company. The general task of the works counselors is to make sure that the company follows the regulations that exist for the benefit of the employees. In order to accomplish this task, the works counselors have the legal right to information, the right to oppose decisions, and the right to co-determination in certain matters that are designated by law. With regard to dismissals, the works council has a right to be heard when employees are dismissed, as well as a right to oppose the decision when employees are dismissed without notice (Oechsler, 1988). The strong role of the trade unions and works councils in industrial relations is characteristic of the German economy (Wever, 1995). This is in contrast to the deregulated labor markets of the USA, which are marked by weaker unions and by lower institutional barriers to layoffs and downsizing (McKinley, Sanchez, and Schick, 1995; Hancké and Soskice, 1997). In the U.S., employment at will is the general rule.

By opening up German markets to direct price and wage competition from abroad, globalization creates pressure on German companies regarding costs. The prototypical pattern of labor relations in Germany seems to represent a disadvantage in international competition, since a strategy of reducing costs through quick layoffs is inconsistent with the prevailing labor institutions that have been described (Kamp, 1997).

However, protecting employees from losing their jobs is an important task of German labor law. The legal regulations distinguish between workforce reduction and capacity adaptation without workforce reduction. Workforce reduction is in turn divided into reductions brought about by the economic situation (*Betriebsbedingte Kündigung*) and socially acceptable dismissals (*Sozialverträglicher Personalabbau*). According to current legislation, dismissals on account of the economic situation mean that a job no longer exists and there is no possibility for the employee to be employed in another vacant job in the plant or company. Seniority provides some protection from this type of dismissal, and those who are victims receive financial compensation for the loss of their jobs. The compensation can be enforced by the works counselor (Halbach, Paland, Schwedes, and Wlotzke, 1997). The term socially acceptable dismissal means that the desired workforce reduction can occur only through attrition, consensual termination agreements, or early retirement programs. In consensual termination agreements, the employee is offered a financial incentive to leave the company voluntarily. Yet another option is gradual retirement, which means supporting part-time work for older employees with help from the state, i.e. from the German Federal Labor Office (*Bundesanstalt für Arbeit*) (Halbach et al., 1997).

Capacity adaptation without workforce reduction stabilizes employment and avoids job loss. One of the most important tools here is shorter working hours (*Kurzarbeit*). This technique involves reducing the regular working hours of the employees when temporary factors –such as a substantial drop in demand– make that necessary. The resulting reduction in wages is partly balanced by payments to the employee from the Federal Labor Office. The conditions for the introduction of shorter working hours are specified in several clauses of the Collective Agreement (*Tarifvertrag*) between the Union and the association of employees. However, reducing working hours is a temporary tool that is applicable for only up to 12 months and can be extended only with difficulty. As this approach burdens the public purse, it is dependent on the agreement of the relevant Labor Office and cannot be implemented autonomously by the company (Halbach et al., 1997).

THE VOLKSWAGEN MODEL AS AN ALTERNATIVE TO ORGANIZATIONAL DOWNSIZING

It seems probable that globalization pressures and the accompanying rhetorics of leanness and flexibility (Spich, 1995) endanger the character of the German industrial relations model (Bertelsmann Stiftung and Hans-Böckler-Stiftung, 1998). However, the example of Volkswagen AG represents an attempt to confront the forces of globalization without disrupting the principle of solidarity which is at the base of German industrial relations and human resource management. In the Volkswagen model, corporate downsizing is not institutionalized as a “normal” response to competitive pressures, but is rather a last priority for cost reduction. The Volkswagen model should therefore be understood as a program that meets discursive tests of legitimation for the acceptability of company policy. The precondition for safeguarding these interests is, of course, maintaining competitiveness (Steinmann and Scherer, 1999).

We begin with Volkswagen AG’s situation in the early 1990s, and present the most important features of the system of employment guarantees that was put in place as the 1990s unfolded. Our overriding goal is to show how the aim of increasing productivity and decreasing costs can be realized without damaging the interests of a company’s employees.

THE SITUATION AT VOLKSWAGEN IN THE EARLY 1990s

At the beginning of the 1990s, the European automobile industry was in crisis. On the one hand it was affected by declining demand, and on the other hand it had to overcome major problems of structure and efficiency. World-wide automobile production was about 39 million cars, while annual demand was approximately 28.5 million. In addition, the internationalization of automobile markets increased pressure on costs, since the Japanese, in particular, were superior on this dimen-

sion of competitiveness (Womack, Jones, and Roos, 1990). Volkswagen AG, like other European producers, was affected by this structural crisis. At the beginning of 1993, automobile sales had declined 20% in Germany in comparison to the previous year. This negative development required dramatic restrictions of production in 1993; this was accomplished through massive reduction of work hours. In the intermediate term, Volkswagen AG had more than 30,000 superfluous employees, taking into account the reduced sales and the productivity potential in the company (Piech, 1993). **Table 1** shows the company's own figures and estimates for the individual factories.

Table 1. Employees required in the Volkswagen factories (omitting apprentices)

Factories	Employees required 1993	Employees required 1995	Difference
Braunschweig	5,700	4,500	-1,200
Emden	9,400	5,000	-4,400
Hannover	14,000	11,900	-2,100
Kassel	14,200	10,700	-3,500
Salzgitter	7,800	5,200	-2,600
Wolfsburg	36,400	21,300	-15,100
others	15,700	13,300	-2,400

Source: Based on Hartz (1994, p. 18)

At that time Volkswagen management assumed that the situation would not change much in the next few years. In order to maintain competitiveness and adapt to the new environmental conditions, a 20% reduction in production costs was necessary, as quickly as possible. This corresponded to an absolute reduction in costs of about 1.8 billion Deutsch Marks (DM), which today is roughly one billion U.S. dollars. Also, the structural problems and deficits in productivity that were revealed by the crisis had to be dealt with (IG-Metall, 1995).

SPECIAL FEATURES OF VOLKSWAGEN'S CASE

To enhance understanding of Volkswagen's response to the crisis and to supplement the discussion of German labor law provided above, it is helpful to review Volkswagen AG's structure of ownership and voting rights, as well as its corporate culture.

THE STRUCTURE OF OWNERSHIP AND VOTING RIGHTS

Employees have traditionally had great influence at Volkswagen, a circumstance that results from the fact that VW was built up as a federal and state industry out of the ruins of the *Kraft-durch-Freude* factories that were formed by the Third Reich before World War II. It was not until 1960 that the Federal Republic of Germany and the state of Lower Saxony (*Niedersachsen*) sold 60% of their shares to the public, and the federal government only sold its last 20% in 1988. Since 1988, the state of Lower Saxony has held 20% of the shares, equal to one fifth

2. German shareholder law demands only a 75% majority for corporations in general.

of the voting rights, and is therefore the most important VW shareholder. The shareholders therefore cannot make any important decisions without the agreement of the state of Lower Saxony since according to Volkswagen AG's constitutional contract more than 80% of the votes are necessary for such decisions. Since the Governor of Lower Saxony is one of the two representatives of the large shareholders on the supervisory board (*Aufsichtsrat*) at Volkswagen, and five of the six German factories are located in Lower Saxony, the interests of employees (who are also voters) are taken into consideration when company decisions are made (Blüthmann and Martens, 1997). Also, the IG-Metall union exerts a considerable influence on company policy, moderating purely capitalistic criteria for decision making. Over 90% of the workers are organized in unions, giving employees strong representation at Volkswagen AG. The strength of worker representation is enhanced by the VW policy that a majority of over 80% is necessary at the General Meeting of Volkswagen AG's shareholders when important decisions are made². Furthermore, the creation or moving of a factory site requires a two-thirds majority vote on the VW supervisory board (IG-Metall, 1995). These policies are of great importance for assuring employment and the survival of individual plants.

A COOPERATIVE CULTURE

Beyond the governance structure just described, an additional special feature of Volkswagen AG is its cooperative company culture, which is based on trying to find consensus on conflicting claims (Hartz, 1994). This VW culture is the result of the company's historical development and the strength of IG-Metall and the works councils. Central features of this culture are:

- dissemination of comprehensive information about the state of the company to the works councils, IG-Metall, and the workers;
- a receptive climate for the unions;
- informal co-determination in advance of formal decisions, leading to fewer conflicts, since many conflicts can be solved in advance;
- a high value placed on consensus in decision making;
- and finally, a norm that decisions made should be carried out.

By emphasizing an orientation toward understanding and agreement, VW is by no means abandoning objectives of profitability and shareholder value. Rather, it is assessing whether the foreseeable results of implementing company policies are reasonable in terms of both efficiency and ethics (Deetz, 1995; Steinmann and Scherer, 1999). As a result of this company culture, the employees at VW can influence company decisions on investments or the closure of certain factory sites.

THE PROCESS OF SOLVING PROBLEMS IN A SOCIALLY JUSTIFIABLE MANNER AT VOLKSWAGEN

Volkswagen's policy of creating consensus, even when the interests of the parties conflict, was mirrored in the negotiations to solve the crisis of late 1993. Consistent with the dialogic principle of responsibility,

according to which the interests of capital and labor should be a joint responsibility of the company (Deetz, 1995), Volkswagen aimed at an agreement that was acceptable to both management and works councils. On the one hand, a reduction in personnel costs had to take place in order to enhance efficiency and take into account the reduced demand caused by the recession in the automobile market. On the other hand, the method for achieving this goal had to be acceptable to the employees (Der Betriebsrat, 1998).

THE ALTERNATIVES

The different options for solving this problem were evaluated by the management board. The traditional approaches, such as early retirement, temporary reduction in working hours, and consensual termination agreements could not be used to adapt capacity for several reasons. A large number of early retirements would not have been affordable, in view of legal changes that made this option expensive³. The period of time during which temporary reduction in working hours was allowed was running out. Besides, reduced working hours would have represented a hardship for individual workers on account of the wages lost. Consensual termination agreements to reduce the workforce would have had serious repercussions for the terminated employees, even if they had obtained generous severance payments. Most of them would have had difficulty finding a new job, since the region of Wolfsburg, where the biggest production plant is located, already had an unemployment rate of over 15%. This solution also would have presented VW with a problem, because the younger workers would have been disproportionately affected by the plan. From the corporation's viewpoint, this alternative would also have been prohibitively expensive, due to the total estimated severance payments of at least two billion DM. And finally, the jobs would have been lost for a long period of time, possibly permanently. All VW factories were in structurally weak regions, or regions that were almost entirely dependent on Volkswagen. The possible dismissal of 15,000 people in Wolfsburg alone would not have been tolerable for this region.

Therefore, the following key question had to be answered:

«How can one raise productivity and yet secure jobs, improve financial performance and yet assure levels of pay, enhance competitiveness and yet still retain expensive manufacturing locations?» (Hartz, 1996, p. 9)

This question was relevant to the company and also to the 100,000 people who worked for it in Germany. The fact that the question was posed in this way suggested that the company was prepared to take the interests of the employees into account, which meant in return that the employees had to be prepared to make sacrifices. This included the willingness of individuals to accept personal disadvantages in order to support the moral rights of all those involved as much as possible (Ulrich, 1997). From a cognitive perspective, opening up new possibilities for avoiding mass dismissals requires the willingness to

3. The applicable law on early retirement was abolished at the beginning of 1996 and replaced by a law that was meant to be an alternative to early retirement. However, the financial framework of this law leads to extreme financial sacrifices for employees.

put up with new, uncomfortable ideas. "Reasonable ideas" have to be disconnected from old patterns of behavior and be newly enacted, as explained below.

RECONSTRUCTION OF THE PROBLEM OF FACTUAL CONSTRAINT AS THE PROBLEM OF ACCEPTABILITY

It is often argued that the market economy limits a company's room for maneuver, making downsizing inevitable and preventing the company from acting in an ethical way because of the pressure to make profits. However, it may not be the "market" or the situation that oblige a company to act in a particular way, but rather managers' cognitions about these phenomena (McKinley, Zhao, and Rust, forthcoming). To avoid such cognitive rigidity,

«[t]he empirical "(im)possibility" problem which is incorrectly interpreted is reconstructed from the perspective of those involved as a problem of reasonability.» (Ulrich, 1997, p. 158, our translation).

This means that the attitude that conditions or outcomes are inevitable must become the subject of normative-critical reflection. In this way, one can decide whether it is reasonable to adopt a particular strategy, or whether there is a more responsible form of action whose consequences are more reasonable for all involved. *To what extent* moral actions are reasonable and *how far* it is reasonable to accept personal economic disadvantages must be answered by weighing up all the claims made, rather than clinging to oversimplified perceptions of inevitability.

In summary, a new definition of *acceptability* must be developed if a company wishes to overcome those barriers that prevent consideration of alternatives to organizational downsizing. Volkswagen saw the term "acceptability" from this perspective (Hartz, 1994; 1996). To the workers, keeping their jobs was a non-negotiable criterion of acceptability. However, from the company's viewpoint, acceptability involved four dimensions that required careful consideration by the employees (Hartz, 1994):

1) *Material acceptability* meant a drop in employment costs. That meant that the employees had to state their willingness to take the special features that their job offered them into consideration as a "second wage." These special features included the quality of the training, the additional pension after retirement⁴, and the special protection through a high degree of co-determination. Viewing these employment attributes as a "second wage" prepared the employees to accept concessions with regard to the actual wage itself.

2) *Functional acceptability* meant the willingness of the employees to qualify and train themselves in different job classifications, should the demands of the market make this necessary.

3) *Geographic acceptability* meant maximizing the utility of neighboring factories. This demanded concessions from the employees to accept

4. After retirement Volkswagen workers receive money from a pension fund which is paid by their former company (*Betriebsrente*). This pension is in addition to the legally mandated pension which is administered by a federal agency.

assignment to different factories and therefore sometimes longer commutes between home and work.

4) Finally, *social acceptability* included dimensions such as the degree to which neighbors within the same local communities were affected. The agreement to this new definition of acceptability by the workforce permitted the company to behave ethically when looking for solutions, despite the strongly competitive environment (Hartz, 1994).

THE NEGOTIATION PROCESS

Volkswagen finally began negotiations with the union in 1993, with the aim of implementing shorter work hours without compensatory payments to the employees. The negotiators were members of the works council of the corporation, the IG-Metall union, the management board, the commission on wages, and the negotiation commission⁵. The following description of the negotiation process is based on our interviews with members of the VW works council.

The workers' agreement to the new acceptability was a pre-condition for the suggestion that the company put forward to shorten working hours. This idea came out of a very simple formula: that a 20% reduction in sales must lead to a 20% reduction in working hours if costs were to be reduced adequately.

This suggestion was received with surprise by the participants in the negotiations, especially the members of the works councils and the union. For the trade unionists, it was at first inconceivable that such a suggestion could come from the company, given the political environment in which the company was embedded at that time⁶. In addition, the suggestion of shortening working hours and doing without a compensatory wage increase meant a break with union tradition. For that reason, the discussions between the spokespersons of the IG-Metall and the committees of the works councils were very acrimonious at first.

However, there was mutual agreement between the partners to the negotiations about the aim of assuring employment. Since the advantages for all parties of shortening the working hours could not be overlooked, this alternative could be interpreted as maximizing common utility. All of those involved came to the same conclusion during the negotiations: the common good could only be assured if all were prepared to subject themselves to new possibilities. However, there was heated discussion about the question of the monthly compensatory payments to the employees.

Solidarity had to be created among the employees for any new alternative to work. In this context, the talks between the members of the works councils, spokesmen of the IG-Metall union, and the employees were of great importance. In meetings and seminars, an attempt was made to show the employees just how serious the situation was. The workforce understood the message after seeing an example of the reduction in working hours required. In addition, leaflets were distributed that were intended to convince the employees of the necessity of shorter working hours.

5. The latter two commissions were formed to focus on particular aspects of the new employment model.

6. At that time German politicians were negotiating an extension of the regular working time as an answer to high labor costs and high unemployment in Germany.

The strategic decisions to assure employment were made by the commission on wages of the IG-Metall union and by Volkswagen AG. The operative decisions, i.e., working out the Volkswagen model, took place on two levels. The wage agreement was worked out by the negotiation committee and was implemented by the works councils. In order to accomplish this, the works councilors met with the employees in sessions where the latter could state their wishes and ideas about the shortening of the working hours (e.g., no additional loss of wages through losing additional payments made for working shifts). The various comments that came from the employees were collected during these meetings, and summarized into main points. Within the framework of the overall strategy, it was then decided which of the points could be implemented. This resulted in a collective labor agreement with the company (*Betriebsvereinbarung*).

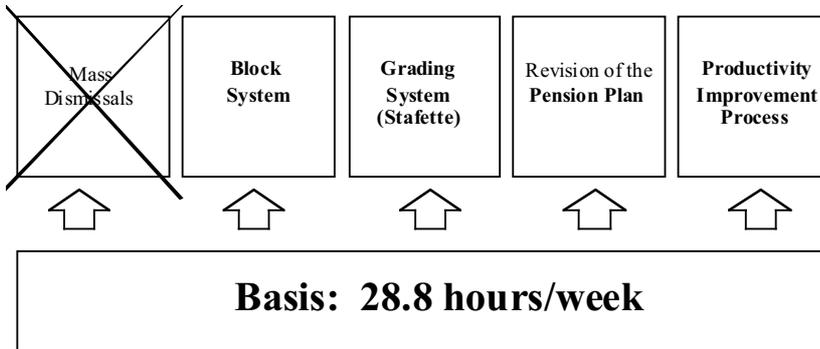
THE SYSTEM OF SECURING EMPLOYMENT

The VW-Employment model developed from this process is especially suitable for showing how creativity can emerge from a crisis, without using the customary step of mass dismissals (Hartz, 1994). The program did not just shorten working hours, although this was the main part of the job preservation plan, but also implemented a catalogue of measures to increase productivity. The Volkswagen model is therefore not just a reaction to the drop in sales, but also shows possible ways to overcome structural crises (Helmer, 1994).

THE NEW EMPLOYMENT MODEL (FLEXIBILITY OF WORKING HOURS)

By introducing new employment models, Volkswagen aimed at reducing personnel costs by the amount that 30,000 employees would cost, but to employ not fewer than 100,000 people. The discrepancy between the level of employment and the level of demand by the end of 1995 was to be covered by the following three employment models: "Four-day-week", "Block system" and "Stafette" (Hartz, 1994; see **Figure 1**). This was not only the fairest and most socially acceptable solution, but in the end even the most cost-efficient solution for the company (see **Figure 2**). As Hartz (1994, pp. 63-64, our translation) points out:

«Comparing the personnel costs per car for 1994 and 1995 proved surprising: Assessing 100 percent personnel costs when continuing with the socially acceptable workforce reduction while, at the same time, working short-time at a maximum level, the costs are reduced by 6 percent in case of mass dismissals. Shortening of working hours without payment compensation, [...], reduced the personnel costs by 13 percent.»



Source: According to the IG-Metall (1994, p. 14) union.

Figure 1. The system of securing employment at Volkswagen

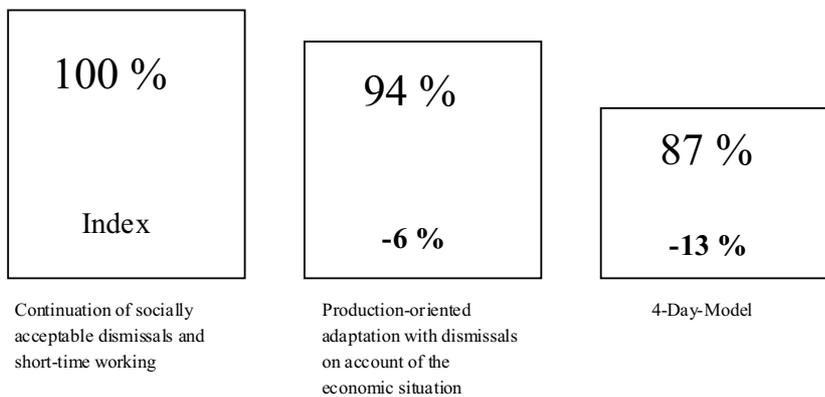


Figure 2. Personnel costs per car (1994/1995 cumulated) (Hartz, 1994, p. 63)

THE FOUR-DAY-WEEK

The four-day-week, the basis of job preservation, produces a reduction of the standard weekly working hours by 20 percent. The actual weekly working hours have been reduced from 36 to 28.8 hours per week since January, 1994. According to the company's cost reduction objectives, the annual income of the employees also had to be reduced. One crucial point was to leave the total monthly pay the same so that every employee could meet his/her monthly fixed costs. With the help of a complex system of charging and additional allowances, the monthly pay was finally stabilized at the level of October, 1993. The system of charging and additional allowances can be explained as follows: Before the new regulations, the annual income of the Volkswagen employees consisted of the following (Hartz, 1994):

- 1) the monthly pay;
- 2) a yearly additional compensation of 96% of the twelfth part of the last year's annual gross income;

3) the holiday pay (vacation bonus) which is paid in addition to the monthly pay and is about 70% of average monthly gross pay. This is paid on 2 fixed dates;

4) and the Christmas bonus, depending on the period of employment duration.

To compensate for reductions in the monthly payment (#1 above), the one-time payments were distributed over the year. Furthermore, two wage increases that had been agreed upon previously were taken into account. First was the agreed wage increase of 3.5% that was supposed to come into effect on November 1st, 1993 but was then suspended for two months. Second was the planned pay increase of August 1st, 1994. Finally, the introduction of the 35-hour week that was projected for October 1st, 1995 was accelerated. The last aspect of the transfer-system was the cancellation of the so-called recovery time⁷. As the sum of these components still was not enough to compensate for the monthly cuts, the company contributed an amount of about 2 percent of each worker's monthly income (Hartz, 1994).

7. This recovery time was a special holiday, introduced in the early fifties by the CEO Heinrich Nordhoff as a compensation for the hard physical strains of the postwar period in Germany.

The following numerical example clarifies these steps (see also **Figure 3**):

«The monthly income of an assembly line worker so far was DM 4,099. With a cut of 20 percent this amount would be reduced to DM 3,279. It will with the transfers and compensations of the different parts of the annual income be made up to the previous level, of which the yearly additional compensation payment of DM 274 makes the biggest share.» (Hartz 1994, p. 67, our translation).

A number of different versions of the basic model portrayed in **Figure 3** were created, to correspond to the different manufacturing conditions in the six Volkswagen AG factories (Frankfurter Rundschau, 1994).

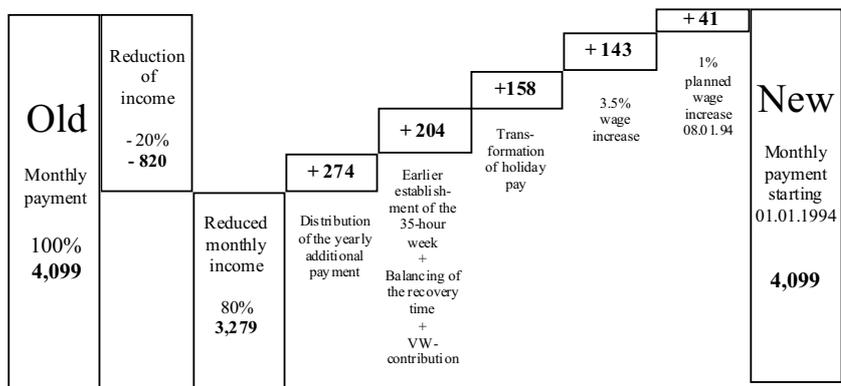


Figure 3. New monthly income with the four-day-week (weekly working hours of 28.8) (Hartz, 1994, p. 67)

BLOCK SYSTEM (*BLOCKZEIT*)

As the existing personnel surplus could not be decreased adequately with just a 20 percent shortening of working hours, Volkswagen also introduced the employment model "block system" (*Blockzeit*), which enables the employees to take days off for a longer period during the year (see **Figure 4**). With this block system the employee can work and can also continue his/her education, depending on his/her economic situation. This model appeals mainly to people between 18 and 30 years old. For this purpose the employment can be interrupted for 3-6 months, depending on the employees' current economic situation. For this period the employee does not get any pay (Hartz, 1994).

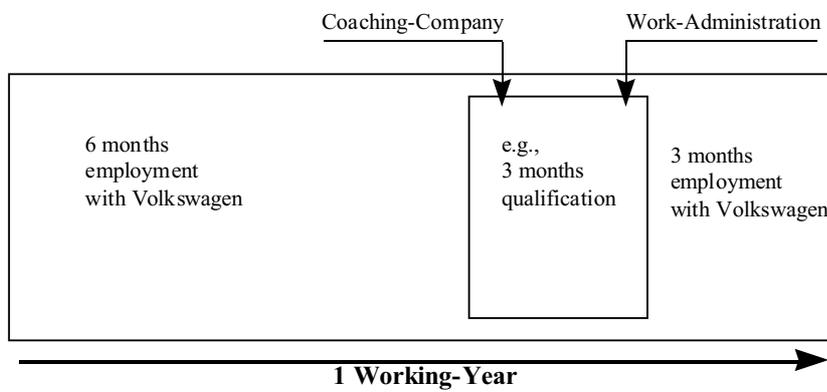


Figure 4. Block system (Hartz,1994, p. 81)

GRADING SYSTEM (*STAFETTE*)

The third measure was the employment model "*Stafette*", which provided for a gradual increase of daily working hours for trainees and a gradual decrease of working hours for older employees. This "intergenerational agreement" is to be implemented over 3.5 years: in the first two years, immediately after the apprenticeship, the career of the newly trained worker starts with 20 hours per week; this is then be increased to 24 hours within the next 1.5 years, and finally reaches 28.8 hours (see **Figure 5**).

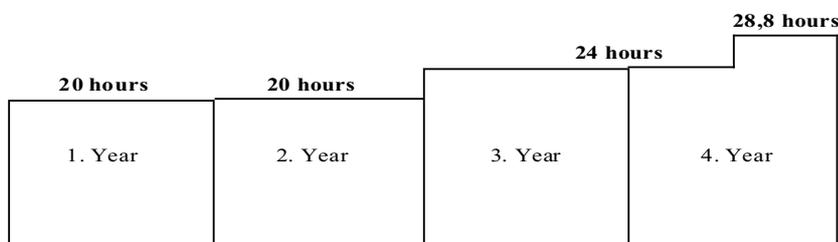


Figure 5. *Stafette* model for the working time of the trainees after their apprenticeship (average working hours per week) (Hartz,1994, p. 84)

In the *stafette* system the working time for younger employees gradually increased, while the daily working time for older employees was supposed to gradually decrease by the same amount. The time dropped from 24 hours per week at 56-59 years of age to 20 hours per week at 60-63 years, until the employee retired. The grading system was the most flexible building block for practice-oriented employment (Hartz, 1994).

MEASURES TO IMPROVE PRODUCTIVITY

To avoid organizational downsizing, it was not only necessary to create work flexibility to cut costs, but also to increase productivity. Therefore, we will describe some of the measures Volkswagen is using to improve productivity (Hartz, 1994; 1996).

THE BREATHING FACTORY

The extensive reorganization of the personnel system formed the framework for the so-called "breathing factory." This term means that resources are ready to be used according to customer orders. Volkswagen AG wanted to attain a maximum delivery period of 14 days for each assembled car. Instead of optimizing capacities and production and filling orders from inventory, the production only worked according to customers' or retailers' orders (Hartz, 1994).

The differentiation between payment and work was a crucial pre-condition for the achievement of the breathing factory. It had to be accepted by all workers concerned. The introduction of a "time account" was therefore an essential condition for the creation of the breathing factory. Exceeding the agreed 28.8 hours per week resulted in a credit of hours as overtime, and those hours could be taken later as leisure time (IG-Metall, 1995).

CONTINUAL IMPROVEMENT PROCESS (*KVP²*)

In the manufacturing sector, Volkswagen supplemented its competitive battle with the continual improvement process (*KVP²*). *KVP²* (*Kontinuierlicher Verbesserungsprozess*) refers to workshops with about 10 to 12 participants from different departments. Assisted by a moderator, the workshop participants discuss possible improvements for the product chain that might immediately be translated into action. With this process, all current manufacturing systems can be questioned. Conflicts resulting from the possibility that improvements might lower personnel demand were avoided by the employment guarantee for all employees.

THE "COACHING-COMPANY"

A core concept of Volkswagen for training and employment was the "coaching-company" idea. The objective of the "coaching-company" was a socially acceptable structural change of the work and the systematic realization of employee innovation. Therefore, one of the tasks of the "coaching-company" was to train the employees during block-lei-

sure time. Besides conventional tasks like further education, measures for developing and training management were also important tasks. The development of managers was considered especially important, and thus the training programs were individually adapted. This kind of coaching suited European individualism and was therefore a strength for international competition. New steps were also taken with human relations research. The "coaching-company" tracked down developments in human relations and management all over the world. The "coaching-company" also had to act as a consulting firm to optimize the processes and finally also had to plan job assignments (Hartz, 1994).

PROBLEMS IN IMPLEMENTING THE VOLKSWAGEN MODEL

The implementation of the Volkswagen model was accompanied by several problems. In particular, the realization of the four-day-week took a long time. In fact, it took four months and numerous discussions before the collective labor agreement took effect on the 4th of April, 1994 in the parent firm in Wolfsburg. The new working hours had to be adjusted to each department and factory according to their special conditions, and in the end resulted in a multitude of different models and systems (Kandel, 1993). Balancing personnel surpluses and deficiencies also did not work as planned. Some departments were short of personnel, while others had an increased work load and the members of the works council had to introduce overtime hours (*Der Spiegel*, 1994). In 1994, the unexpected increase of demand in the automobile market confused the process of implementing the new system. Volkswagen could not handle all the incoming orders with only 28.8 working hours. At factories like Hannover or Braunschweig, the workers had to work overtime. Compensation, resulting in an increased claim for leisure time instead of extra pay, caused annoyance among the workforce. Therefore, the reason for the shortening of working hours had to be explained to the employees once again after the publication of reports about increased sales (Bode, 1994).

REACTION OF THE WORKFORCE TO THE VW-MODEL

The quality of management decisions and of their implementation increases if the workforce accepts the decisions from the very beginning. Therefore, the reaction of the employees to this new system was of the utmost importance. In the beginning, the majority of the workforce could not understand the information and could not imagine working 20% hours fewer than previously. Thus, acceptance varied from worker to worker.

Some of the employees did not mind the new system, while others ignored the situation and refused the suggestions of management with arguments suggesting that the management just wanted to draw a gloomy picture of the situation because of coming wage negotiations.

Only a few, and especially those who already worked short-time and whose jobs were directly endangered, recognized the reality of the situation and were willing to make sacrifices. They showed the most willingness to shorten their working hours. The following statements from the employees reflect this willingness:

*«Shortening the working hours is much better than mass dismissals.»
(works councilor Volkert, quotation acc. to Süddeutsche Zeitung, 1993)*

«It would of course be very hard to get less payment, but we are well prepared to share.» (worker Hoffmann, quotation acc. to Voges, 1993)

«Most of the colleagues are prepared to contribute in order to avoid dismissals and a social plan.» (worker List, quotation acc. to Voges, 1993).

Solidarity was not present in all parts of the company, however, as the following statements from workers suggest (quotations acc. to member of the work council Fritsch).

«I am quite sure that I will not be dismissed.»

«We always worked overtime. So where is the necessity to cut working hours?»

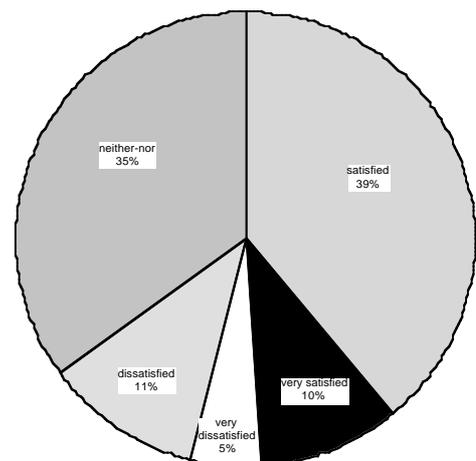
«You should not give up basic principles of trade unions so easily.»

Three years later the works council characterized the workers' mood as very good. The majority of the employees accepted of the new working times, especially the four-day-week, as can be seen in **Figure 6**.

Interviewing the workforce:

«How satisfied are you with the 28.8-hour-week ?»

Very satisfied: 10%
Satisfied: 39%
Neither-nor: 35%
Dissatisfied: 11%
Very dissatisfied: 5%



Source: According to FORSA, quotation according to Hartz, 1996, p. 18

Figure 6. Acceptance of the Volkswagen-model

Following are some quotations that represent the opinions of the majority of the workers:

«We do not have a chance somewhere else, I do not fool myself. It is important to assure jobs.» (assembly-line worker, quotation acc. to Der Spiegel, 1994)

«I prefer to get less money, instead of many colleagues being dismissed—that is the solution we decided upon.» (outside finish worker, quotation acc. to Der Spiegel, 1994)

«I remember in the past we went, still tired, to early shift and came, again tired, from late shift. We quickly had to wash the laundry and to tidy up the kitchen. Now I have enough time for my children and can cook for them myself.» (worker, quotation acc. to Der Spiegel, 1994)

«Two hours more to sleep each day, that means quality of life.» (worker, quotation acc. to Der Spiegel, 1994)

In particular, the new continual improvements and the fact that workers were asked for their opinions, experiences, ideas, and suggestions made the workforce enthusiastic (Deutsch, 1993).

It can be said that the workforce finally accepted the reduction of the working hours, although they were uncomfortable with the loss of pay. A 53% majority of the employees could only cope with difficulty with the financial loss resulting from the four-day-week (Hartz, 1994). Because of the different variations in the model, no greater frustrations occurred. However, the workers could not forget the loss of income. The most important reason that 75% of the employees of the different workforce groups agreed to the new model was to assure jobs (Hartz, 1994).

THE POSSIBILITY OF TRANSFERRING THE VOLKSWAGEN MODEL TO OTHER COMPANIES AS AN ALTERNATIVE TO ORGANIZATIONAL DOWNSIZING

Transferring this system from Volkswagen to other companies, industries, regions, or even countries would only be possible in some respects.

The structures and policies of the company are embedded in the specific historical development of Volkswagen, which is not always comparable to other companies or even other countries (Der Betriebsrat, 1998). This refers not only to legal conditions but also to the communication-based relationship between the board of directors and the works council, and the culture of consensus at Volkswagen, which was indispensable for developing the model. To implement this model in other companies, it would be necessary to change the companies' cul-

ture so that socially relevant decisions were made on the basis of a widespread consensus (Leisinger, 1997).

The comparatively high base pay at Volkswagen also increased the acceptability of the financial cuts resulting from the flexible organization of the working hours. Since the wage rate of factory workers in other regions is below that of VW, the implementation of shorter working hours in other companies causes more problems (Prein, 1993). Moreover, the internal pay agreement of Volkswagen AG, which was formed between the IG-Metall union and management, eased the implementation of the Volkswagen model. It is much easier to find a tailor-made solution for a specific company situation and to fix a single internal pay agreement than to fix a general pay agreement (*Flächentarifvertrag*) which has to do justice to all companies and branches in a region. Different companies often have different employment situations that cannot be taken into consideration in a general pay agreement (Hartz, 1994).

A transfer of the Volkswagen solution to companies in other countries, for example the United States, would presumably be even more difficult, because the development of this system also has to be seen in the context of the industrial relations and the institutional framework of the Federal Republic of Germany. As previously illustrated, German industrial relations are constructed in such a way that a company can only pursue a cost competition strategy with difficulty (Hancké and Soskice, 1997). On one hand, a German company cannot force down wages as all wage negotiations are conducted by strong industrial trade unions. On the other hand, the works councils in many German companies often slow down quick, cost-effective solutions. The whole institutional context forced Volkswagen to concentrate on more than simple cost leadership strategies and to look for new solutions in cooperation with the works councils. Recession and competition forced adaptation, but the institutional frame of industrial relations constrained its form (Hancké, 1997).

CONCLUSION

Volkswagen thought that a cut in working hours, instead of mass dismissals, was a correct alternative as it was the best way to take all interests into account.

The advantage of assuring the employees their jobs is quite obvious: Uncertainty about losing one's job and not finding another job in the structurally weaker regions around the Volkswagen plants is eliminated. With the Volkswagen system, trainees can also count on their jobs. The model of employment assurance also means less likelihood of plant closings, since the company is forced to call back orders to their own production lines that were previously outsourced (IG-Metall, 1995).

The advantage for the company is obvious: cost reduction. First, mass dismissals with costly severance pay and settlements are avoided.

According to various estimates, the costs of such payments in Volkswagen AG's case would have been approximately two billion DM. Second, the company still has its educated, skilled workers. Additionally, the company is saving money by reducing working hours and raising productivity. The model of reduced working hours is cost saving and advantageous for international competition (Hamel and Prahalad, 1994). The greatest advantage, however, is that creative potential stays with the company. Productivity gains, which are absolutely necessary to remain competitive, would never be possible without a stable workforce, as the motivation of the employees is a necessity for ambitious rationalization aims. Improvements of the organization of work are not possible without the creativity and ideas of the employees. International competitiveness can be improved by such a model as Volkswagen's, as it considers human resource development and creates enough flexibility to react to actual orders. The advantages of the positive image of Volkswagen should also not be underestimated (IG-Metall, 1995).

The benefit for society is not only the prevention of mass dismissals but also the effect on the labour market. In this particular case, the dismissal of 30,000 employees would have cost the state about 2.3 billion DM per year in unemployment benefits, social insurance, and tax deficits. The reduction of working hours and thus of total employment income also results in lower tax revenues for the public accounts. In the case of Volkswagen, the lowered revenues (tax, pension scheme, and health insurance) amounted to about 600 million DM. Therefore, with the Volkswagen model, the state had lower costs of about 1.7 billion DM. Finally, the political threat to a democratic society of mass unemployment, especially in structurally weak regions, was reduced (IG-Metall, 1995).

Most recently, in January 1999 the Wolfsburg plant of Volkswagen has returned to the three shift model which was the norm before 1993. The motivation for this was a certain number of limitations in the new Volkswagen employment model. For example, there were problems of coordination arising from the various shift-models, because there was a different combination of workers from day to day on a given shift. This led to difficulties in interaction during work, which in turn resulted in quality problems. The theoretical implication that might be drawn from this is that informal, intuitive work rules that arise from the process of interaction are critical in accomplishing technical goals. In addition, the Volkswagen model produced some uncertainty in the workers' family and social lives because it was difficult to predict from week to week when the workers would get home. Despite these problems, Volkswagen still applies most of the components of the new Volkswagen employment model (the 4 day week, *Stafette*, the Block System, continuous improvement, and the Coaching Company system). In particular, Volkswagen retains the concept of the breathing factory to respond flexibly to changes in demand. For example, in Wolfsburg the number of cars produced is projected to be 730,000 in 1999 compared to 641,000 in 1998 (Martens, 1999).

Considering today's situation at Volkswagen AG, it appears that the company has successfully overcome their crisis without mass dismissals. The company now sells more vehicles relative to the time of the crisis in 1993, when sales dropped by 25% to 1.4 million cars (Volkswagen, 1993). In 1997 Volkswagen AG sold more than 1.7 million cars, whereas the whole Volkswagen Group (including Audi, Seat, and Skoda) sold 4.25 million cars worldwide. In the German factories extra shifts are often necessary (Volkswagen, 1997). The approximately 99,000 employees in Germany (as of Dec. 31, 1997) now have enough work because of the rise in demand and because of the recent introduction of new car models (Voges, 1997). During 1996 Volkswagen was able to realize an increase in productivity of 9.4% relative to 1995 (Volkswagen, 1996). The positive order position also affected revenues, and profits are rising again. Whereas in 1993 Volkswagen AG's profit was only 71 million DM, it was 630 million DM in 1996 and 966 million DM in 1997 (Volkswagen, 1993; 1997). Although a full transfer of the employment guarantee system at Volkswagen to other companies would be difficult because of company specific features, this system could, in combination with similar measures, potentially help mitigate corporate downsizing in other companies (*Süddeutsche Zeitung*, 1993). As shown by the Volkswagen solution, there are a few points that are applicable to industry in general. For example, companies clearly have to organize working time flexibly as soon as they decide to avoid downsizing. In this context, it is important that corporate actors and workers reconsider their expectations and redefine what is acceptable on both sides in order for the companies to conform to social responsibility norms. Otherwise organizations will have a greater tendency to attain productivity increases through mass dismissals.

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