

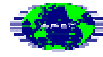
**COPING WITH ASIAN ECONOMIC CRISIS: THE RIGHTSIZING
STRATEGIES OF SMALL AND MEDIUM ENTERPRISES**

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ABSTRACT

Hong Kong has been experiencing the worst economic downturn in decades for the last two years. What, how and to what extend the SMEs have done to overcome the situations are unknown? Given the apparent importance of retrenchment to small firm survival and success in economic turmoil, but its clear neglect in a Chinese socio-cultural environment, this paper provides in-depth knowledge of the rightsizing strategies of Chinese small and medium firms in Hong Kong. The research results suggest that SMEs in Hong Kong exhibit different human resources practices at different stages. In the 'restricting stage', SMEs reduce or stop intake staff and restrict overtime for the existing staff to deal with the fall of sales and oversupply of manpower. In the 'trimming stage', SMEs scale down or streamline the operations. In the 'proactive stage', SMEs request the existing staff to work overtime and start to hire new staff with lower pay but higher technological competencies to prepare for the recovery. A tentative model for rightsizing strategies of Chinese small and medium firms in Hong Kong is proposed.



INTRODUCTION

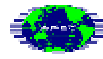
Starting from October 1997, Hong Kong has experienced as other Asian countries the worst economic crisis of the last few decades. The impact has been more widespread than expected. Hong Kong is going through an economic adjustment period. The employers are under pressure to restructure their organizations by reducing their overheads, operating cost and increase productivity by way of lay-off, downsizing or reduction of wage (Cheung, 1999).

In Hong Kong the small and medium enterprises (SMEs) have made up more than 90 percent of the total establishments. They are the hardest hit sector of the economy. When the external environment is averse, the strategic options for organizations would usually be aiming at improving the internal environment: resources, capabilities and core competencies (Hill and Jones, 1995). Resources include the firm's financial, physical, organizational and human resources. Capabilities represent the firm's capacity to deploy resources to achieve a desired state. Core competencies are the source of the competitive advantage for a firm and distinguish a company competitively and reflect its personality. By definition, SMEs have a smaller number of staff than their larger counterparts. With a lean structure, limited resources and core competencies, the SMEs face greater difficulty to cope with the downturn.

LITERATURE REVIEW

Facing the worst economic downturn in Asia, firms in Hong Kong start a wave of turnaround in the hope to combat this external influence. An empirically-driven conceptual model has been developed by Pearce and Robbins (1993) to explain the turnaround process. Two phases of turnaround responses: retrenchment phase and recovery phase has been discussed in the model. Retrenchment consists of a combination of cost cutting and asset reducing activities and followed by recovery response to regain their pre-downturn level of performance (Hofer, 1980). One of the most common means of retrenchment is cost cutting by downsizing that is a reduction number of employees, but it may or may not change the composition of businesses. However, many firms that downsized only partly met their goals of reducing expense, increasing productivity and competitive advantage (Hitt, Ireland and Hoskisson, 1997).

The issues of whether, when and how to downsize are clearly important. Cameron (1994) and Cameron, Freeman and Mishra (1991) have discussed the prescriptions of best practices for downsizing. Baron and Kreps (1999) have considered the process issues on downsizing to attenuate the psychological cost for workers and reputational costs for the company and suggest ways to minimize the adverse effects. Hitt, Keats, Harback and Nixon (1994) have discussed the effective as well as ineffective downsizing practices. There are nine downsizing practices have been proved to be ineffective. The first four practices relate to reduce workforce: implement voluntary early retirement programs; make across-the-board layoffs; make deep reductions of staff and implement layoffs slowly in phases over time. There are another four practices that relate to survivors: place survivors in challenging jobs for which they have insufficient skills; expect survivors to work harder; emphasize employee accountability in place of



employee involvement and promise high monetary rewards rather than careers. The last ineffective practice that relate to eliminate training and development program. There are nine downsizing practices that have been proved to be effective. The first four relate to manpower adjustment: reduce the number of layers/levels rather than the number of individual positions; consider the interdependent relationship before cutting particular positions; rightsizing: instead of focus on how much to cut, seek the appropriate size; continue to hire, grow, and develop in priority areas. There are another three relate to survivors: identify and protect individuals with strong leader in the organization; empower key individuals and ensure maximum flexibility and emphasize team effort and team building among remaining units. The last two relate to development and competencies: protect and promote educational programs and identify and protect core competencies. The effective downsizing practices emphasize rightsizing by reevaluating the appropriate size of the organization periodically. Rightsizing is a specific way of downsizing that when downsizing is necessary, the cuts are done in a way that the firm's human capital changes do not affect strategic competitiveness (Hitt, Keats, Harback and Nixon, 1994).

The SMEs have adopted retrenchment during economic downturn. The retrenchment activities did improve the performance of the small firms studied (DeDee and Vorbies, 1998). They used both cost and asset reductions in their retrenchment. The recommendations for practitioners are clear. When they have to retrench, they should cut those factors as they can be easily rehired or repurchased in markets that are not related to the core of their competitive advantage (Michael and Robbins, 1998).

RESEARCH OBJECTIVES

To date, there is no research into the rightsizing strategies of small firms in a Chinese socio-cultural context. The purpose of this study is to explore the various HRM strategies and practices that the Chinese SMEs in Hong Kong employed to overcome the economic downturn. Specifically, the research objectives are:

1. To examine the extent to which rightsizing strategies have been adopted by Chinese small firms in Hong Kong;
2. To identify the human resource practices exhibited by Chinese SMEs in Hong Kong at various stages; and
3. To propose a tentative model to explain the rightsizing strategies, specifically related to major human resource practices, adopted by Chinese SMEs in Hong Kong.

RESEARCH METHODOLOGY

This is an exploratory study based on a case-study design (Yin, 1989). This allows multiple sources of data to be included in the collection and analysis. Data were obtained from two sets of interviews. A semi-structured interview schedule was used to collect information. McCracken's (1988) long interview techniques guided the interview and provided focus on a series of open questions pertaining to human resource



practices in small firms. The average duration of each interview was one to two hours. Interviews were recorded and transcribed accordingly. The grounded theory approach (Glaser and Strauss, 1967; Strauss, 1987; Strauss and Corbin, 1990) was used to analyze the interview script.

The first set of interview is with three key officers in the Hong Kong Labour Department with a thematic interview guide consisting of opened questions were used to uncover the background for this study by revealing the context for general labour and labour relations situation in Hong Kong. The second set of interview is with sixteen owner managers of SMEs. The interview is based on a semi-structure interview schedule with open-ended questions so that the SME managers are able to discuss their human resources strategies and practices in overcoming the economic downturn.

One chief labour officer from the Labour Relations Unit, one senior labour officer from the Workplace Consultation Promotion Unit and a registrar from Minor Employment Claims Adjudication Board were interviewed in May. Information gathered regarding the latest statistics and labour market situation and the labour department's role in assisting companies during retrenchment.

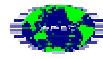
Sixteen owner managers of SMEs were interviewed during May, July and August. They were asked to discuss about the economic downturn and its impact on their organizations with different periods of difficulty in form and/or extent if such periods do exist. The corresponding human resources strategies and practices for different periods of difficult time were reviewed with their underlining reasons given by the owner managers.

HONG KONG SITUATION

The Asian economic crisis provides a chance for Hong Kong to evaluate the past and plan for future in terms of appropriate company strategies for firms and government policies. The economic downturn is a combined result from the Asian regional downturn and the burst of asset price bubble. Being a small and open economy, the crisis has pushed Hong Kong to reevaluate not just its market mechanisms but also its high land and labour costs and productivity (Enright, Scott and Leung, 1999).

SMEs have played an important role in the economic development in Asia. There is no precise definition of an SME. They can vary in terms of size and can be distinguish as follows: micro with 0 to 19 employees; small with 20 to 100 employees and medium with 101 to 500 employees (UNCTAD, 1998). Using this definition, more than 96 percent total establishments in Hong Kong can be classified into this category. The importance of this group of organizations and its impact on Hong Kong economy is indisputable.

In general the labour relation scene is relatively peacefully in Hong Kong. In the Report of the Commissioner for Labour 1997, it states the economic conditions took a down turn after late October together with the easing back of tight labour situation. The number of trade disputes and the number of claims handled by the Labour Relations Service have been on an upward surge from 1997 to 1999. The increase between 1997



to 1998 is about 50%. However, the increase in the first quarter of 1999 is about 8.5% for trade disputes and 19.3% for claims. These reflected the increase of labour disputes mainly resulted from wage cut and lay off that have been happening in Hong Kong. After experiencing more than eighteen months of difficult times, in recent months, although the number of disputes has increased, the employees tend to be more willing to negotiate and settle in disputes.

To provide advice to employers seriously affected by the economic downturn, the Labour Department has written the 'Guidelines on What to do if Wage Reductions and Retrenchments are Unavoidable'. It is highly recommended that employers should enter sincere discussions with their employees to find solutions and allow employees a reasonable notice period between 7 to 14 days for decision on proposal. It is also suggested that the employers should assure employees that if the company's situation worsens further, and retrenchment has to be considered, severance pay will be calculated at an employee's wage level before the wage reduction scheme was introduced. If possible the employer should assure employees to have appropriate adjustments if the performance improves. The Labour Department is fully aware of the distresses that the employers and employees have been through. In time of difficulty, harmonious labour relations underpin Hong Kong's prosperity and success. The 'Guide to Good People Management Practices' sets out a series of good practices in order to build up teams of highly motivated and efficient employees who will in term achieve the competitive advantage for their respective companies.

FINDINGS - SME's HRM PRACTICES

From the interview conducted with the Chinese owner managers, specific human resources practices used for turnaround to overcome the economic downturn have been revealed. The most common practice that they adopt is downsizing in one form or the other. The following is to illustrate the human resources management practices from the interview results.

Cut Staff Development Fund

Distinct human resource wheel or human resource process is not apparent among the interviewees. Being a sub-contractor of major exporters in Hong Kong or prestigious overseas importer, most of the Chinese SMEs work as a production arm. Thus, the Chinese SMEs perform as an order-taker, as suggested by Siu (1997). Chinese SMEs would cut their operation costs as low as possible. Hence, the staff development or expenditure will only be kept at a minimum level. Neither well-designed training programs nor human resource development activities are found. Finding it difficult to tackle the recession due to the financial turmoil, some of the owner managers even admit that they cut the budget for recreational activities for the workers as well.

One owner-manager recalled: "Normally, we will have ball games and competitions every month. I will arrange some gifts for the winning teams. Now,



they could have their games and competitions, I would not pay for any banquet nor presents”.

The interview results suggest that the Chinese owner-managers perceive that human resource as a peripheral function to production. Thus, they will cut the staff development fund immediately in view of the financial crisis.

Wage Cut

During the financial crisis, the major objective of the SMEs is to maintain normal operation and proper cash flow. Thus, they will cut the salary expenditure. Interestingly, however, they would not choose to lay off workers before cutting of wages. Rather, they try to cut their entire salary expenses in a very subtle manner.

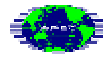
For workers on wage system, the owner managers would start out by cutting their work in overtime, which in term save a big amount of wage expenses. In the past overtime work is part of the workers regular work with higher pay. The workers rely heavily on this part of income and the SMEs depend on these extra working hours to complete their order without hiring extra manpower. In times of trouble, cutting overtime work is the first option that the owner manager and the workers would both agree to carry out. This is a form of wage cut by restricting the working hours to their normal hours.

One owner-manager remarked: "We previously used a quota system to motivate our workers. We identified the average production level of skillful workers. Then we set the quota at 70% of the average production level. Thus, every worker could attain the basic salary. We allowed worker to work overtime as they could earn more. Even facing the financial turmoil, I do not want to lay off workers. Thus, we do not allow them to work overtime at present. Previously, if we did not allow overtime work, workers would resign immediately. Now, most of them know the business environment is not good and they accept our arrangement. As long as we could have a proper cash flow, we would like to maintain our operations at a normal level."

For the middle and senior management, the owner managers of SMEs used another approach. As the family members are mostly the senior managers in the company, they would cut their own salaries to a minimal level.

One owner-manager mentioned: "It is a family business. The family members form the management team. We understand the current situation. We only have the basic salary. I remembered in the most difficult time, I worked with no salary for over three months. As I lived in the factory, I tried to stay there and kept my daily expenditure as low as possible."

Analysing the interview transcript suggests that the Chinese managers will try to maintain the operations. Reasons for this are unknown. Be that as it may, it is a family business and they would try to maintain the continuity. Or they perceive that sales will be picking up soon. Notably, however, they absorb the salary cut subtly. For workers, the owner managers tend to prefer not to allow overtime work than cutting



the wage across the board as long as they can as a measure to reduce the wage expenditure. Also, the family members work with no salary to maintain the operation in a proper cash flow. Thus, the nature of family business tends to affect the operations significantly.

Lay Off

If the situation does not improve much, actively they would start to lay off part of the workers and passively they would encourage natural attrition. If a supervisor resign, the owner manager will not try very hard to retain him or her. However, this approach is not effective in some cases.

One manager remarked: “My assistant resigned. She decided to resign because she wanted to get married and have a baby. As she wanted to be a housewife and we also faced the financial turmoil, I did not urge her to stay on. I asked my brother to take charge of her work. Initially, we thought it was a good arrangement. First, we cut the salary expenditure. Second, we could absorb the job by our existing staff given the slow sales. However, it was not as we have expected. The workload was not double; rather it was triple or even more. We were busy at "extinguishing fire" daily and could spend less time on quality control. A customer put in a claim because of poor product quality!”

Human resource as a functional area does not have a major role in corporate planning. The interview results suggest that the Chinese owner managers do not have detailed job analysis and human resource planning. Their poor planning or lack of planning in eliminating or combining posts created hardship for the survivors.

Plan For Recovery

After using various measures of downsizing, the situation has stabilized for some of the companies. The owner managers of those companies predict that their business might pick up in a short period of time and they forecast the need for more quality employees.

One of the managers commented with enthusiasm: “We can see the light from end of the tunnel now. It might take about six months for us to move out from the bottom of the valley. As we have cut down our product line and become more focus on our high quality items to maintain our competitiveness, we need to equip ourselves with high quality employees that they are of high capability and productivity to sustain our new direction.”

This group of companies has either started to hire quality staff to join their company or planned to do so. However, the newly hired staff is for the new business direction or competitiveness that the companies have defined for. The new recruits are different from those that they have dismissed. Some of the owner managers view this economic downturn as positive. They felt that because of the downturn, they found it easier to hire quality employees at a lower cost and mobilize their employees for changes that were necessary in order to reshape the company. The owner managers are



more willing to share their vision for the future and become more conscious to reevaluate the appropriate size of the company periodically. The companies are thus healthier than they were before the crisis.

A Dilemma Case

Some owner managers commented that they did not practise active downsizing by dismissing some of the employees because their companies were not able to afford severance or long service pay. As they have not established provident fund for their employees, they can not finance this large sum of extra payment related to dismissal of employees. This is a great dilemma for the SMEs. On one hand, lay off would be too costly for them in this time of hardship. As an alternative, carry a group of employees with no work for them for extended period of time is a heavy financial burden as well.

One manager disclosed: “ It is a suicide one way or the other. If we lay off the employees in order to cut down our expenses, we have to borrow from the bank or somewhere to pay them off. As most of them have worked for us for more than five years, the amount of funds required for dismissal is alarming. With our present situation, this is like cutting our throat. However, by keeping all the employees with limited work, this is like bleeding to death.”

The way out for this group of companies is to reduce asset as a way maintain their liquidity and aggressively look for other markets for orders to prolong their chance of survival. This group of companies is generally weak financially, if the economic situation can not move out from its bottom in the next six to eight months, they may have problem to maintain their businesses.

A Success Case

However, the human resource management process and the market orientation are interrelated. Using Ford and Rowley's (1979) categorisation, Chinese owner-managers can be classified as the owner-managers or the professional managers. The professionally managed companies conformed far more closely with, compared with the owner-managed companies, the theoretical model of the marketing concepts, particularly in respect of explicit analysis, planning and control of the marketing function. The professionally managed companies exhibit distinct human resource activities and adopting effective downsizing and rightsizing practices.

The following interview excerpt from a professionally managed company shows the differences: "Yes, we had a very difficult time as we encountered slow sales mainly due to inadequate orders from our major buyers. Lay off workers is the only strategy to maintain our operations. The employment size was reduced from 500 to 300. Fortunately, one of our major product lines is coffeepot for hotels in Europe and the US. This is a simple classic product and we could have steady orders during the financial turmoil. We could make use of this product line to maintain our operation level. After that, the employee turnover rate of our company was quite low. However, we tried to add value onto our existing product in order to have a competitive edge over our major competitors. The whole management team was involved in the new product



development. We recruit 100 new workers specifically for this new product. At present, the sales figure of our new product increases steadily. Facing the financial crisis, we are not able to operate with profit. Thus, I cannot give any bonus to the senior and middle managers as we normally did in previous years. I understand that they have worked very hard. I talked to them and I agreed to distribute some of my shares of the company to them if we can survive this crisis. With the full cooperation of staff, we can maintain our operations. Last quarter, our sales increased slightly. I expect we could attain break-even this financial year.”

Also, the professionally managed company does not perform as a production arm of the export houses or overseas importers. They also develop their own products. Thus, they have to use innovative approach to motivate their employees rather than cutting costs. An overlapping task force is formed to develop new products. There are also open communications among employers and employees in professionally managed companies. Figure 1 shows the relationship among the human resource practices of SMEs, external and internal environments and perception of the owner-managers.

A TENTATIVE MODEL - SME's RIGHTSIZING STRATEGY

To summarize, what have the Hong Kong SMEs done to overcome the economic crisis? The most commonly turnaround strategy that the SMEs have adopted is retrenchment. Under retrenchment, downscoping and downsizing are the most favour options for the SMEs. However, the downscoping would be less significant for the smaller companies as they have limited unrelated business for them to divest. For some of the SMEs, they did not just react to the situation by downsizing alone; they have adopted rightsizing to increase the firm's capabilities to overcome the crisis. There are three stages for rightsizing strategy, each stage with its corresponding practices reflecting different degree and nature of difficulties that the firms are facing in their external environment and how they tackled them.

Table 1
Stages for SME's Rightsizing Strategy

<u>Stage</u>	<u>Focus</u>	<u>External/Internal Environment</u>	<u>Turnaround Response</u>	<u>Major Human Resources Practices</u>
1	Restricting	Bad	Retrenchment	Moderate downsizing
2	Trimming	Worst	Retrenchment	Drastic downsizing & wage cut
3	Proactive	Improving	Recovery	Rightsizing

In Table 1, we have summarized the focus, environmental situation and major human resources practices for different stages. Stage 1 is the 'Restricting Stage' that the companies start to find themselves facing low sales that they have not experienced in years. They would reduce or stop intake of staff and restrict overtime for the existing staff to deal with the fall of sales and oversupply of manpower. They would also



drastically reduce or cut their expenses on items that they felt is peripheral in nature like the staff development and recreational funds. Stage 2 is the 'Trimming Stage' that the firms find themselves unable to survive with the restricting practices only as the demand situation getting worst. They would encourage natural attrition and carry out reduction of staff and/or pay to trim down the operation in head count and overhead cost. For those companies with unrelated and unprofitable businesses, the management would opt downscoping to streamline the operation. Stage 3 is the 'Proactive Stage' that the company has survived so far and found that the decline of sales has levelled off. Their measures to overcome the adverse environment have been successful. If they predict that the economic situation in the near future or/and their new focus of maintaining their competitive advantage has been successful, the owner managers would place greater emphasis on maintaining and recruiting quality employees. They would request the existing staff to work overtime and start to hire new staff with lower pay but higher technological competencies to prepare for the recovery.

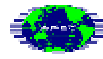
The first two stages belong to the retrenchment phase of the turnaround response for the SMEs to cope with the economic downturn. The third stage belongs to the recovery phase of the turnaround response for those SMEs that have survived so far to increase their capabilities and core competencies in order to equip themselves for economic recovery.

As SMEs have limited capacity to influence the external environment, all they can do to overcome the economic crisis would be to make themselves as efficient as possible internally. Rightsizing seems to be an effective strategy that it would not be for the retrenchment response to overcome the situation of economic downturn only and it includes the recovery response that prepares the company for the economic upsurge that would eventually come as the downturn ends.

CONCLUSIONS

In the past, Hong Kong has faced many challenges and on each occasion, we have emerged stronger, better and more vibrant. SMEs should treat this economic downturn as another challenge for them to improve themselves. By working together, the owner managers and their employees can rebuild their company not just to survive the adversity of the external environment and to be prepared for the recovery of the environment.

The human resource strategies of Chinese SMEs depend on the relationship with their buyers. If they perform as a production arm, human resource management will be considered as a peripheral function and limited resources will be allocated to human resource activities. Professionally managed companies place much more emphasis on human resource management and innovative measures to motivate staff are found. The influences of the nature of family business are still profound. To lay off employees would not be on the top of the consideration set. They will use the family members as a buffer to absorb the operating expenditure.



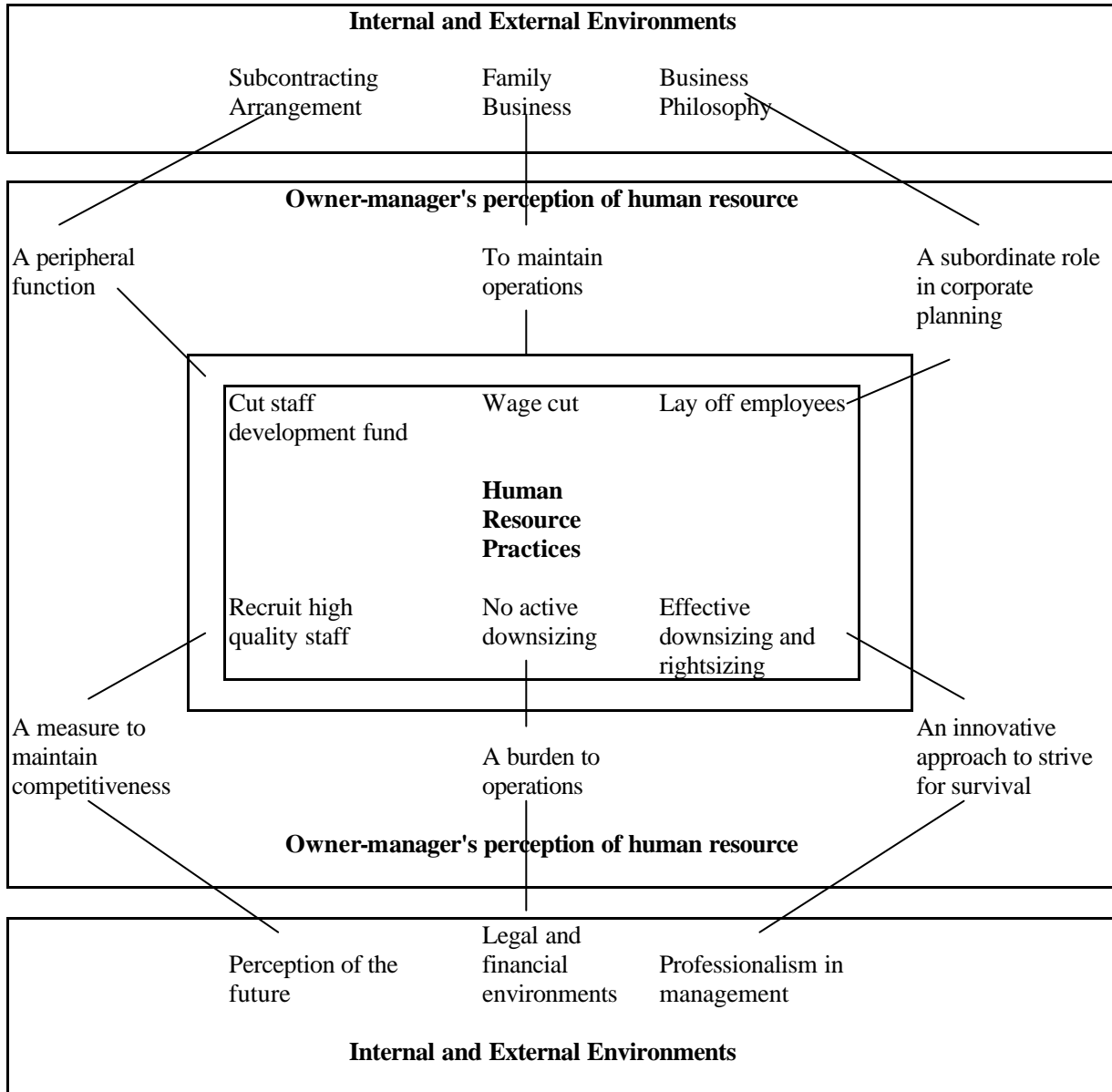
The rightsizing strategy that seems to be effective for the SMEs is in fact can be linked to and supported by the Pearce II and Robbins' (1993) model for turnaround. As described by Pearce II and Robbins (1993) and Robbins and Pearce II (1992), the rightsizing strategy is the recovery response that is necessary to follow the retrenchment response in order for successful turnaround to occur.

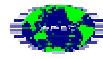
Future research might fruitfully focus on differentiation effective and ineffective retrenchment practices in various size, industry and environmental context. To follow Mroczkowski and Hanaoka's (1997) idea, we can carry out a comparative study of effective rightsizing strategies in various Asia countries instead of their Japan and American study. The finding of this study also suggest that a particularly promising line of research may be an investigation to test the stages for rightsizing strategy and its corresponding effectiveness. Hopefully, such efforts will increase the practical utility of the SME's strategic management and human resources practices.



Figure 1

The relationship among the human resource practices of SMEs, internal and external environments and the perception of the owner-managers





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