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ILR Impact Brief - CEOs and Layoffs: Sometimes the CEO Suffers Similar Fate

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ILR Impact Brief - CEOs and Layoffs: Sometimes the CEO Suffers Similar Fate

Abstract

Mass layoffs have become an all too familiar occurrence in the United States; statistics indicate that an average of 5.7% of all employees lose their jobs in a typical year. And while many cutbacks were once meant to be temporary – that is, until demand picked up or the plant was retooled for a new model or new product – these days they more often have a permanence intended to reduce costs and boost efficiency. Companies may expect certain outcomes from workforce realignments, such as higher profits and greater productivity, but sometimes the future of the company's chief executive is also at stake.

Previous academic studies have found links between CEO tenure and company performance. For example, researchers have shown that the probability of management turnover decreases as a company's stock price increases. In a slight variation on this theme, researchers have also shown that CEO resignations/firings tend to rise as a company's prospects deteriorate. This particular study goes a step further and explores the relationship between layoff announcements (another indicator of company performance) and chief executives' term in office.

Keywords

chief, executive, officer, layoffs, downsizing

Comments

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IMPACT BRIEF

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CEOs and Layoffs: Sometimes the CEO Suffers Similar Fate

Research question: Are chief executive officers more likely to lose their jobs in the first year or two following the announcement of mass layoffs?

Conclusion: The relationship between employee layoffs and CEO turnover has varied over the 1970-2000 time period examined in this study and depends, in part, on the particulars of the company and its chief executive. There is limited evidence that announced layoffs are positively associated with the probability that a CEO will resign. The chances of this happening are significantly greater when the price of a company's stock drops in response to the planned reduction in force; with layoffs increasingly perceived as good news for companies, however, in recent years stock prices have reacted less negatively to these events.

Workplace implications: The labor market for chief executives is not immune to the aftershocks of mass layoffs. Decisions about workforce reductions may be motivated by a CEO's desire to retain his or her own job, but other constituencies' interpretation of the event matters more. Corporate boards and investors may regard layoffs either as a sign of management failure or as a furthering of strategic goals. Perceptions and subsequent actions by these stakeholders will determine whether the top executive is punished or rewarded.

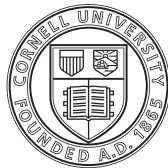
Abstract: Mass layoffs have become an all too familiar

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occurrence in the United States; statistics indicate that an average of 5.7% of all employees lose their jobs in a typical year. And while many cutbacks were once meant to be temporary – that is, until demand picked up or the plant was retooled for a new model or new product – these days they more often have a permanence intended to reduce costs and boost efficiency. Companies may expect certain outcomes from workforce realignments, such as higher profits and greater productivity, but sometimes the future of the company's chief executive is also at stake.

Previous academic studies have found links between CEO tenure and company performance. For example, researchers have shown that the probability of management turnover decreases as a company's stock price increases. In a slight variation on this theme, researchers have also shown that CEO resignations/firings tend to rise as a company's prospects deteriorate. This particular study goes a step further and explores the relationship between layoff announcements (another indicator of company performance) and chief executives' term in office.

To be sure, top managers of American corporations tend to come and go. Analysis of the 31 years of data used in this study shows that management turnover has increased over time. The research further reveals that on average, 12.2% of companies hire a new chief executive in any given year. It also observes that companies that have announced at least one mass layoff are nearly twice the size (in terms of stock market valuation) of those that have not, are more likely to have a CEO with less on-the-job seniority, and are more likely to replace



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their CEO in the year following the announcement.

Although layoffs are significantly related to CEO turnover in the years analyzed here, the impact on CEO tenure has weakened over time. The study shows that publicized job cuts affected CEOs most negatively in the 1970s and slightly less so in the 1980s, when the probability of a CEO being replaced was greatest in the second year after layoffs were announced. During the 1990s, however, the relationship between job losses and CEO turnover was almost nonexistent; still, chief executives are relatively more likely to lose their jobs if other jobs in the company are eliminated.

By way of possible explanation, the authors note that the stated reasons for layoffs have also changed over time. In the first two decades of the study, companies typically claimed layoffs reflected declining demand for products or services. By the 1990s, reductions were seemingly undertaken as part of reorganizations intended to buoy performance and profits. Related research by one of the authors (Hallock) and a colleague suggests that cuts made during the 1970s and 1980s were generally regarded as bad news (i.e., a sign of internal problems and managerial failure) by company directors and shareholders, but as better news (i.e., signaling the potential for improved outcomes) in the 1990s. Building on those findings, the researchers here show that, indeed, the response of company stock prices to layoff announcements has become less negative since the 1970s.

So, if share prices tended to drop more precipitously in the earlier years of the study than in later years, what is the connection, if any, between the market's reaction and CEO turnover? Quite a bit, it seems. The data show that declines in the price of a company's stock following an announced layoff are strongly associated with a higher probability the CEO will be fired; conversely, increases in share prices tend to insulate the CEO from such an outcome.

How business cycles and the CEO's relationship with the board of directors affect his or her job tenure are additional factors that remain to be explored.

Methodology: The researchers culled data on layoffs, CEO hirings/firings, and finances and accounting from 500 companies for the years 1970-2000 to run a series of regressions that would predict the probability of CEO turnover. The data were drawn from *Forbes* magazine, Standard & Poor's indices, the Center for Research in Securities Prices, and the *Wall Street Journal*.

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