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Understanding the New Reality of Layoffs and Helping Employees Find Solutions to Cope

Center for Advanced Human Resource Studies

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Abstract

KEY FINDINGS

· In general, job tenure in the United States has shortened significantly over recent decades, particularly for relatively older male workers.

· Stock prices, which used to react negatively to job loss announcements, began to react less negatively in the recent past, and now tend to react slightly positively.

· CEO pay is correlated with layoffs, but, when company size is controlled for, there is no relationship between CEO pay and layoffs.

· Laid-off workers are less well off than in the past, in terms of subsequent wages, reemployment, and health.

· While there are some alternatives to layoffs, firms tend not to use them.

Keywords

Employee Engagement, HR Strategy, Compensation, commitment, satisfaction, loyalty, wages, layoffs, HR investments, unemployment, job loss

Comments

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Understanding the new reality of layoffs and helping employees find solutions to cope

THE TOPIC: HOW LAYOFFS HAVE BECOME A FACT OF CORPORATE LIFE

Lifetime employment with one company used to be fairly commonplace for many workers, and employee layoffs were a last resort for many employers. A common condition of employment was the "implicit contract," whereby the employer gave an unwritten promise to shield the worker from fluctuations in the marketplace and to provide employment for decades, in return for continued productivity and a high measure of employee loyalty.

In this study, "Job loss and the fraying of the implicit employment contract," ILR School professor Kevin F. Hallock looks at the ways in which the implicit contract has been changing, along with shifts in the job market and employee loyalty.

The study also discusses the growing presence of "churning," or incidence of workers holding a job for less than one year, and other trends in job tenure. In addition, he discusses the corporate practice of mass layoffs. These changes in the job market have certain effects on workers' long-term employment prospects, earnings, and even health.

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THE STUDY QUESTIONS

In this paper, Hallock examined the following questions:

- **Are workers less committed to firms, and are firms less committed to workers, than in the past?**
- **Why are workers laid off? Have the reasons changed over time?**
- **Has job duration changed over time?**
- **How do layoffs affect workers? How do they affect firms?**
- **What are some possible alternatives to layoffs?**

THE RESULTS

The implicit contract has been fading. As the job market has become more fluid, employee loyalty and lifetime employment have both become increasingly scarce.

Unemployment is high, job tenure is shortening, and layoffs are becoming not only prevalent, but more socially acceptable.

Job loss has adverse effects on workers' short- and long-term employment prospects, compensation, and even health.

By and large, corporations do not seem to benefit significantly from layoffs, in terms of subsequent profits or executive compensation.

Shareholders are increasingly viewing layoffs as a routine corporate practice.

Alternatives to layoffs include such solutions as widespread work reductions, work-sharing unemployment insurance, and voluntary early retirement. However, these options largely fail to appeal to many corporations and employees.

Layoffs' detrimental effects on workers

One indicator of the fading implicit employment contract is job tenure. And workers, by and large, are remaining with a given employer for shorter and shorter amounts of time. According to Farber (2007, 2008), private-sector workers' average tenure has dropped significantly, as has the percentage of workers experiencing longtime employment (the effect is concentrated on male, especially older, workers in the private sector). Approximately one-fifth of all jobs have less than one year of tenure.

Job loss has serious harmful effects. About one-third of displaced workers (defined in the Displaced Workers Supplements to the Current Population Survey [BLS] as someone who has lost or left employment because the facility or company closed or moved, there was insufficient work available, or his or her position or shift was abolished) remained unemployed about two years after being laid off.

A large percentage of laid-off workers who previously worked full time subsequently found only part-time work, and on average, displaced workers earned 13 percent less than they had previously (Farber, 2005). In addition, displaced workers earned about 17 percent less compared with the earnings increases of their non-laid-off peers (Farber, 2005). Laid-off employees also continue to suffer long-term wage losses, up to two decades later (Jacobson, LaLonde and Sullivan, 1993, and Von Wachter, Song, and Manchester, 2009). But the losses are not just financial. Workers experiencing job loss also have an earlier incidence of death (Sullivan and Von Wachter, forthcoming) and are more likely to experience depression (Dooley, Catalano, and Wilson, 1994).

The increasingly routine nature of layoffs

In the past, companies tended to resort to mass layoffs as a last-ditch effort to remain financially viable. Over the last four decades, however, companies have become increasingly sanguine about the practice. Even companies that previously had a track record of no layoffs have begun to lay off employees.

Companies are now citing more routine reasons for cutting their workforces (see Figure 1). For instance, "slump in demand," perennially the most cited reason, has become less prevalent—perhaps because firms now view layoffs less as a reaction to an economic downturn, and more as part of a long-term strategy to remain competitive. By contrast, in recent decades, there has been a striking increase in corporations' citation of "cost-control" issues as their reason for layoffs.

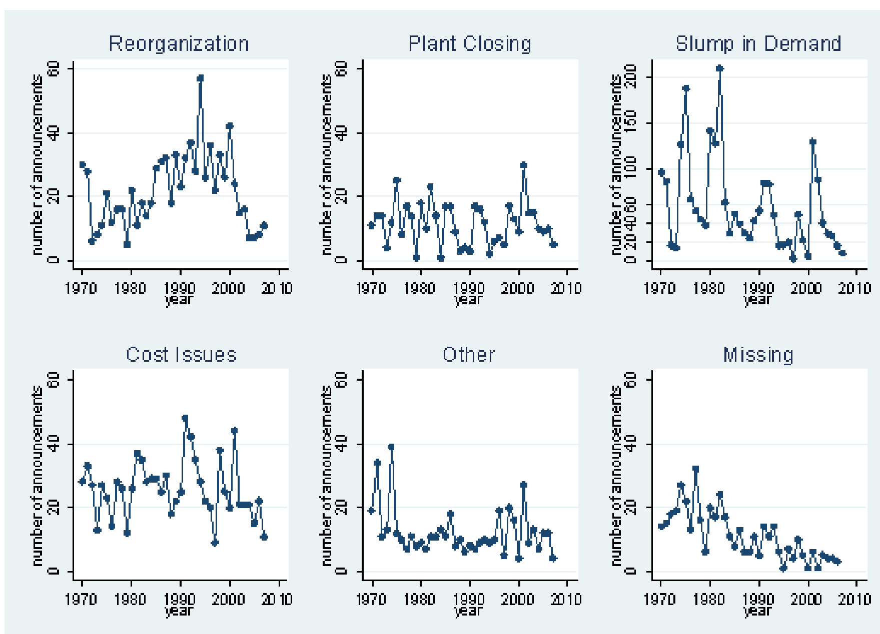

Fig 1. Distribution of Stated Reasons for Layoff Announcements Over Time

In addition, companies are issuing layoff announcements on a more routine basis. Firms used to announce layoffs toward the end of the calendar year, or after the winter holidays. However, these announcements have become much more evenly distributed over the calendar year.

Corporations realize little downside, or upside, as a result

While corporations' stock prices used to drop in response to layoff announcements, Hallock's study shows that the markets' response has become neutral to even weakly positive (the study controlled for concurrent company or market news that might have affected stock prices, such as earnings, dividend and stock split announcements, see Figure 2). While a corporation's decision to lay off workers might signal distress, it might also simply indicate the company's efforts to improve its financial condition—and thus be interpreted positively by investors.

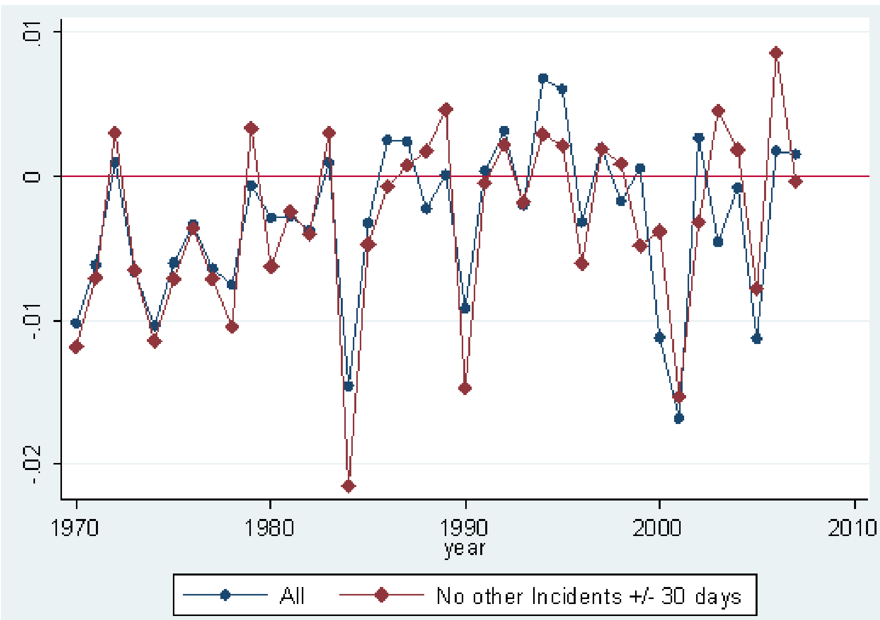

Fig 2. Cumulative Average Excess Returns (One Day Before to One Day After the Lay-off); showing that the share price reaction to job loss announcements was typically negative in the 1970s, but seems to have flattened out and more often become positive by the middle to end of this decade.

However, companies that lay off workers do not seem to realize enhanced returns on assets or returns on stock, versus companies that have no layoffs (Cascio, Young, and Morris, 1997). And, while chief executive officers commonly receive extra compensation following a layoff action, when firm characteristics are accounted for, the pay premium becomes negligible (Hallock, 1998).

Some alternatives to layoffs, and why companies rarely choose them

Rather than laying off workers, companies can choose strategies such as widespread pay cuts, selectively reducing workers' hours, or in 17 U.S. states, using work-sharing unemployment insurance (WSUI). The problems are that employees seem to prefer full-time work at full pay, and corporations often prefer to have primarily full-time workers. Wage cuts can depress worker morale and productivity, and even encourage some workers to seek full-time, full-pay employment elsewhere.

When faced with a potential layoff situation, some companies will offer employees a certain degree of choice about their fate, such as asking workers to cut back their hours on a voluntary basis, "lending" workers to nonprofit organizations at a reduced pay rate, or allowing employees to work reduced hours on a telecommuting basis (Cascio, 2002). Some employers also offer employees a degree of choice through early-retirement incentives.

Employers can also participate in WSUI, whereby workers reduce their hours and pay by 20 percent, but then become eligible for a prorated fraction of unemployment insurance benefits. Although work-sharing programs are used in several developed countries and in 17 U.S. states, WSUI is unpopular and very few companies use it.

In some countries, government policies afford workers more protection than those in the United States. In India, for instance, businesses with 50 or more workers must provide 30 days' advance notice of a layoff and 15 days' pay for every year of work completed (Asher and Mukhopadhaya, 2006). However, corporations tend to maneuver around protectionist policies—for example, by hiring contract workers who are much easier to terminate.

Some organizations help laid-off workers through educational training (Muirhead, 2002), or re-employment bonuses (Robins and Spiegelman, 2001), which can speed the transition to a new job.

Since layoffs do not materially benefit corporations, and worsen employees' earnings, job prospects, and health, it is worth considering why so many individuals continue to be laid off. Possibilities include that either layoffs offer more benefits than their alternatives; or that workers as a group and firms prefer layoffs to many alternatives suggested. Or, perhaps, organizations and policy makers have simply not yet discovered reasonable alternatives that could substantially benefit both parties.

THE TAKEAWAY

- **As layoffs appear to be an increasingly accepted fact of work life, perhaps it would be best to implement public policies that help workers with the transition from one job to the next.**

- **Economists and policy analysts should consider whether and when changes in institutions and laws regarding employment make sense. For instance, should employers receive some tangible benefit from using WSUI versus not using it?**

- **Organizations and policy makers should consider the labor-readjustment programs used in other countries. When it comes to avoiding mass layoffs, companies may need to use more aggressive and larger-scale thinking than is currently the norm.**

THE DATA SOURCE

Hallock recorded all data from each job-loss announcement in the Wall Street Journal from 1970 to 2007, for any firm that was ever listed in the Fortune 500 during that time. For each of these 5,353 articles, Hallock collected the primary, secondary, and tertiary reasons for the layoff, the number of workers affected, and whether blue- or white-collar employees were affected.

Hallock also interviewed 40 senior managers about job loss, querying them about how truthful they felt the reports to be and about what they thought might be the real reasons behind the layoffs, in addition to their general thoughts about job loss in the U.S. and throughout the world.

THE RESEARCHER

This study was conducted by:

- Kevin F. Hallock, Director, Institute for Compensation Studies (ICS); Professor and Chair of the Department of Labor Economics and Professor of Human Resource Studies; Research Director, Center for Advanced Human Resource Studies (CAHRS), ILR School, Cornell University

For an in-depth discussion of this topic, see:

Hallock, Kevin F. (2009) Job loss and the fraying of the implicit employment contract. Journal of Economic Perspectives, 23(4), 69-93.

- **Questions about this research should be directed to Kevin Hallock at hallock@cornell.edu.**

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