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The Relationship Between Announced Layoffs and Financial Performance

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THE RELATIONSHIP BETWEEN ANNOUNCED LAYOFFS AND FINANCIAL PERFORMANCE

Carol E. Goldman, B.S.

An Abstract Presented to the Faculty of the Graduate School of Lindenwood College in Partial Fulfillment of the Requirements for the Degree of Master of Human Resource Management

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ABSTRACT

This thesis focuses on the impact of downsizing on financial performance. Downsizing has become a catchall term for plant closures, eliminating entire layers of management, and even subcontracting large amounts of a firm's operations. Although many American firms are downsizing they often do not consider what they are trying to achieve by cutting jobs or closing plants. Generally, U.S. companies are eliminating jobs in their organizations in an attempt to cut costs believing that to do so will increase profitability and result in more efficient organizations. It is naturally assumed that any strategic change in a corporation, such as downsizing, is the realization of an attempt by management to enhance shareholder value.

This thesis hypothesizes that layoffs may have a short term positive effect on financial performance but do not result in a positive effect on the long term performance of a company. This hypothesis is tested by selecting and comparing two groups of companies; those that have announced layoffs and those that have not. A total of 49 companies were selected for the study, 16 of which had announced layoffs and 33 which had not. The comparison was made by analyzing eight financial

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performance measures for a period of seven years with particular focus on stock price, a short term measure, and Return-on-Equity (ROE), a longer term measure of financial performance. While stock price reflects investor's expectations, ROE reflects actual corporate performance.

Today many management incentive plans are tied to short term performance in the form of stock options. The results of this analysis indicate that it is possible to inflate the value of stock in the short term by announcing a plan for downsizing. The market perceives an immediate reduction in cost and a corresponding increase in profitability and projects this performance into the future. The actual performance of the group of companies announcing layoffs, as reflected in the ROE, does not improve with the announcement of layoffs and actually increases a downward trend at a period two years subsequent to the announced layoffs. Furthermore measures of productivity of human capital, specifically Profits per Employee and Sales per Employee, show a significant downward trend in the group of companies announcing layoffs as compared to the group not announcing layoffs.

The group of companies announcing layoffs demonstrated comparatively poor financial performance in the two years prior to the announcement of layoffs. This downward trend was not reversed with the announcement of layoffs. The only measure of financial performance considered in the study which did experience a positive move in the year

of the announced layoffs was the Price/Earnings ratio indicating an increase in the price of the stock relative to its earnings. The evidence of the study supports the hypothesis that while short term financial performance may be effected positively by layoffs, longer term performance does not undergo a positive effect. This result implies that further consideration should be given to the overall value of layoffs. Although layoffs may be viewed as a sometimes effective component of reengineering the corporation when specific objectives are in mind, the evidence does not support the contention that layoffs can be seen as a direct means of improving corporate financial performance. An additional implication of this analysis suggests that executive compensation plans should incorporate long term incentive components.

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1996

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Chapter I

INTRODUCTION

Historical Perspective - Downsizing

Downsizing has become a catchall term for plant closures, eliminating entire layers of management, and even subcontracting large amounts of a firm's operations. American businesses are downsizing, however, many companies do not consider what they are trying to achieve by cutting jobs or closing plants. The new motto for American companies is cut the fat, slash the excess, get lean and mean (Lord 79).

Historically, downsizing has not always been the method of choice to help cut costs. Until very recently, a layoff was viewed as a sign of poor and inadequate management. Companies would do whatever they could to avoid letting their employees go. It was the choice of last resort. Today, it is often the only option considered. Rather than firing management that creates the need for a layoff, some companies, as in the highly publicized case of Eastman Kodak, are firing senior executives who are unwilling to lay off or downsize employees (Lesley and Light 100).

The history behind the acceptance of this practice goes back to the Great Depression of the 1930s. From that time through the 1970s, a layoff was not a permanent firing but only a temporary stop in work -- work

that would resume as soon as the business improved. Laid-off workers were often given a small stipend while they waited to be called back. In those days, a layoff was actually more humane than firing. It showed the employer's willingness and commitment to do whatever it could to get the employee back on the payroll. Generally, today a layoff means a permanent termination of employment (Dentzer 58).

Some of this public acceptance of layoffs can be credited to American society's rigidly and widely held belief in a just world, the grandfather to the Protestant work ethic. The belief that everything happens for a just reason dictates that those who were laid off probably deserved it. By holding on to this idea, we create the illusion of control and job security. Because someone is a good employee and hard worker, he will never be laid off. The unfortunate reality is that employees rarely have any control over a layoff, and those who do lose their jobs suffer the effects of an undeserved black mark on their employment record (Dentzer 58).

Reasons for Downsizing

Most U.S. companies are eliminating jobs in their organizations to cut costs. Companies believe downsizing will increase profitability and result in more efficient organizations. Right Associates, a Philadelphia-based consultant, conducted a downsizing survey for a five year period,

(1987 - 1992) of 1,204 American companies. Three-quarters of the companies downsized during the past five years. Three-quarters of the companies also said their financial performance had not improved and two-thirds said they had not seen any improvement in productivity. Employees who survived the cuts felt insecure and uncertain about future plans of the organization. It is hard to raise productivity levels when morale is low and employees are uncertain about their future and the future of the organization (Lord 79).

Eastman Kodak Company wanted to improve profitability by cutting costs in the organization. The company has cut 12,000 jobs since 1985 and downsizing has not improved employee productivity or the financial performance of the company. Many corporations have used downsizing methods to increase expected earnings, and have been disappointed with the results. Kodak has experienced the financial results that are prevalent in most downsizing organizations. Often, downsizing does not positively affect financial performance (Leslie and Light 100).

Downsizing companies often cut management layers to increase financial performance. Major corporations such as IBM, AT&T, and General Motors have delayered their management organizations. Sixty-five percent of Fortune 100 companies have reduced their management staffs between 1987 and 1991 (Bergmann, DeMeuse, and Vanderheiden 510). Companies from all geographic locations are changing their

management structures and delayering organizations. General Motors eliminated management layers, closed 21 plants and eliminated 74,000 jobs in 1993 after losing $8.7 billion (Lord 79).

As might be expected, some companies undertake downsizing for the wrong reasons, merely to keep pace with what the competition is doing or because someone thinks it will save money, rather than as a result of calculated decisions to revamp processes or sell off certain product lines. Some additional motivations for downsizing include pressure to lift the stock price and executive compensation plans with components driven by short term financial performance. Some companies mistake "downsizing" for "reengineering," rather than recognizing that downsizing should be part of an overall reengineering effort. Sixty-five percent of companies believe that periodic downsizing has become essential to staying competitive (Bergmann, De Meuse, and Vanderheiden 510). Firms realize they have to change their size and shape to adapt to changes in their business environments. Few firms considered what they were trying to achieve by eliminating jobs; they just said it would make them more competitive.

Companies that try to remain competitive by downsizing should decide the reasons for the job eliminations. Jobs cannot be eliminated without restructuring the job duties. Remaining employees feel overworked and burned out. Becoming too lean involves major risks,

such as losing core talent to job burnout. Surviving employees are expected to pick up the responsibilities of former employees (Bunker 61).

Construct Definitions

For purposes of this study, several terms are defined. A corporation is defined as a social institution organizing human efforts to a common end (Drucker 23). The corporation is a legal construction designed to serve as a vehicle for focusing shareholder investment in the creation of capital while insulating the shareholder from liability. This study reviews the performance of a corporation in terms of financial metrics as they are influenced by an organization restructuring.

It is assumed that any strategic change in a corporation, such as downsizing, is the realization of an attempt by management to enhance shareholder value. However, it is not clear that long term financial performance sustains the typical short term improvement in stock price resulting from a reduction in employee numbers and therefore costs.

The sample set of companies will be drawn from the medical products industry. All companies will be public with annual revenues in excess of [$500 M]. The information collected will focus on performance of a corporation in the period after downsizing. The time period will include the year of the layoff announcement, and two years following the completion of downsizing. Investor returns before the downsizing can be

reasonably characterized in a period of two years. The process of downsizing may take several years during which stock prices will reflect short term expectations of the results of downsizing. A period of two years from the completion of downsizing should capture the longer term actual impact on performance reflected in return on equity. Therefore the time period studied will be five years.

Downsizing is the traditional corporate response to management finding itself under pressure from a competitive industry and relatively poor current or anticipated future financial performance. The term downsizing has become a colloquium for plant closures, eliminating entire layers of management, and even subcontracting large amounts of a firm's operations. Generally, the goal of downsizing is to reduce cost and increase productivity of human capital. Downsizing generally has the following components:

1. An examination of current and expected future corporate performance as bench marked against the industry sector as a whole and specific competitive threats
2. A study and determination of the organizational structure required to improve performance
3. Management agreement among the decision makers on the changes required in current organizational structure
4. A review and assessment of current human capital resources

5. Determination of layoffs required to support new organization structure requirements
6. Implementation of layoffs and reorganization structuring

These steps in some variation constitute the process of downsizing, from the identification of a need for downsizing through the actual implementation (Henderson 4).

A corporation is a legal construction intended to act as a vehicle for the formulation of capital. Shareholders invest in a corporation under the premise that management has a fiduciary responsibility to maximize the use of shareholders equity in the creation of capital. The return shareholders demand for the use of their investment is a function of the risk they perceive. Therefore, while investors will not expect the same level of return from a low risk investment as a high risk investment they will expect a competitive rate of return from like investments. The medical products industry sector, is not expected to generate returns equal to the computer software industry, as an example, because the perceived risk of the investment is much lower in the medical products industry sector than in the computer software industry sector. However, within the medical products industry sector investors will expect that companies desiring the use of their equity provide a return at least equal to the average for the sector. Companies not performing well will see their stock price punished

by the market as shareholders sell out to seek other opportunities for investment.

This study will focus on two primary financial metrics, stock price and Return-on-Equity (ROE). Stock price reflects the market's expectations for future earnings and what it will pay today to purchase that future earning capability. Even if performance today is questionable, when the market believes future performance will be good, the stock price will reflect that expectation. Stock prices reflect short term expectations and can swing considerably on new information interpreted to have an effect on future earnings. Return-on-Equity (ROE) represents the return generated today on invested equity. Its calculation has no connection to expectations for future earnings. It is based solely on current, recorded performance and is calculated as the ratio of earnings per share to the equity in the corporation. In other words at the end of the year ROE is the measure of how well the company has done in employing shareholder equity to generate earnings.

Stock price and ROE have been chosen as indicators for interpreting the financial performance implications of downsizing because together they represent the perception of the benefits to future performance of downsizing, as reflected in the stock price, and the actual performance, as reflected in ROE. A continuing debate exists on the proper construction of management incentive plans. Today many plans

are tied to short term performance in the form of stock options. As should be clear, it is possible to pump the value of the stock in the short term by announcing a plan for downsizing. The market perceives an immediate reduction in cost, a corresponding increase in profitability and projects this performance into the future. The result is often an increase in stock price. Whether the actual performance of the company improves is more closely reflected in the ROE. However, it is rare that management's compensation is tied to ROE. Financial performance data can be collected through a number of venues; annual reports, company 10Ks and 10Qs, on line services providing historical corporate financial performance data, industry sector analysis sources that reports performance by industry sector, and finally the company surveys (Brealey 53).

Statement of Purpose

The time has come to question the basic assumption that layoffs are an acceptable tool for business success and growth. The data are in, and they do not support the widespread and indiscriminate use of layoffs of the past decade. The author feels that it is imperative to take a hard look at a practice that is dreadfully painful – painful to management, employees, communities, investors and company performance.

Generally, layoffs create a downward spiral that can boost financial results in the short term but also create a need for multiple, successive

layoffs to maintain those results. Like an anorexia of the organization, it begins depleting the business of its fat, then its muscle and finally its brainpower. Layoffs emerge as a risky, painful and inhuman form of management that only in the worst cases can resuscitate a dying organization (Lind and Sulek 375).

This study will explore the effects on both short term and long term corporate performance of downsizing. Specifically, it is expected the information in the thesis and survey will substantiate the following thesis: "The financial performance of a corporation can appear to be positively affected in the short term by downsizing, but in the long term will experience a decline as a result." The study will also discuss the adverse consequences of downsizing on human capital and downsizing alternatives.

Announced layoffs also have a negative effect on the employees that remain in the organization. Productivity declines because employees are afraid, do not want to volunteer extra time and energy, and are uncertain about the future of the company and their value in the organization. Morale and loyalty often decline. Most employees do not have the desire to work long hours and start new projects. Remaining employees often look for jobs outside the company, where they feel more job security. Companies need to invest more in their workers and provide training opportunities for the surviving employees. Management should

take an active role in communicating with surviving employees and recommending training programs that will enable the employees to cope with the additional job responsibilities (Reich 54).

Generally downsizing organizations have a lot fewer people doing all the work that was done before, and the people are stressed out and overworked. Sometimes they are doing the jobs of two or three people, working long hours and in most cases are less productive. Most organizations need to review the tasks and see if some tasks can be eliminated. Most organizations do not look at the systems, methods and procedures used, to see if they are needed; if they did, they would find a lot of waste in what people are required to do (Vogl 26).

There is growing evidence that companies should stop using layoffs as a remedy for improved financial performance. Sometimes, it is necessary to downsize in the organization. A company can use creative cutbacks to help cut costs in the organization without automatically eliminating staffing requirements. Some organizations use wage freezes to help reduce costs. Companies can also reduce salaries or utilize hiring freezes to save jobs. There are viable alternatives that work in organizations other than the standard downsizing methods (Dentzer 58).

Evidence suggests that announced layoffs have a negative affect on employee productivity and negatively impact financial performance. Employees should be an organization's most valuable asset, and greater

attention to their importance in long-term planning is needed. Companies must decide what they are trying to achieve before they downsize. If they merely downsize without considering the problems, the results will be a smaller company with the remaining problems. Evidence also suggests most companies will constantly look for ways to slim down, and this is one diet that may never end. The most important concept to remember is to do the necessary things to keep skills current and competitive in the workforce (Dentzer 58).

The circumstances surrounding the termination notice can have a lasting impact on the success of the transition for the company, the impacted employee and for the person notifying the employee. If the notification process is cold or mechanical with an emphasis on protecting the assets of the company instead of the dignity of the individual, the process works against itself. The person must be able to leave with his or her self-esteem. It makes no sense for an employee who has been working late alone in the office for 20 years to be escorted out the door by a security guard. Employees should be recognized as contributors to the company, not damaged goods. Callous treatment demoralizes the person being notified and those who are witnessing the process (Vogl 26).

It is the author's contention that the information presented in this study will strongly support the hypothesis that downsizing may increase short-term financial performance but downsizing decreases long-term

financial performance. Also, downsizing results in lower morale and more sick days per employee. Although corporate downsizing is a normal response for struggling companies; evidence suggests financial performance does not always improve. The results show financial performance worsened following announced layoffs and the morale and loyalty of the remaining employees suffer. Employees are less likely to volunteer extra time and energy in a downsizing environment. Announced layoffs have a negative influence on employee productivity and negatively affect long-term financial performance.

Chapter II

LITERATURE REVIEW

Statement of Hypothesis

Downsizing may be the most under-researched practice in the current world of business. Empirical examinations of the different causes, results and dynamics of downsizing remain at a low level. Many managers base their downsizing programs not on scientifically validated guidelines but on anecdotal information from peers who have previously downsized, or prior personal experience gained from a series of downsizing efforts and gut feel for what is proper. It is no surprise, therefore, that most downsizing initiatives have failed. Often the stocks of firms that downsize eventually dropped below the industry average. In this light, more research on downsizing should be conducted (Cameron 183).

During this study, the financial performance of medical products corporations that have downsized will be measured against medical products corporations that have not downsized. The research presented in this study will strongly support the hypothesis that there is a decrease in long-term financial performance of medical products corporations that

have downsized as opposed to the same type of medical products corporations that have not downsized.

Arguments in Favor of Downsizing

Many corporations have used a layoff to save their corporate hides for the short-term. IBM, Digital Equipment Corporation, Macy's, Continental Airlines, and General Motors have boosted their quarterly earnings during times of tremendous financial difficulty by slashing the payroll. They effectively averted a financial crisis that surely would have meant disaster had they not dramatically cut their expenses. The layoffs bought them time (Downs 57).

Eliminate employee deadwood

In addition, a layoff can make a reorganization much easier on management. Anyone who has managed a group through a restructuring will testify that hiring an employee through a newly created position is much easier than trying to coddle existing employees so they accept the new. Layoffs can also relieve some of the high payroll expenses in a company. A layoff can also help with the problem of obsolete workers (Bell 22). Laying off those whose skills are not up to par makes room for a new crop of employees whose abilities are more current. Many executives see the layoff as a quick way to purge the organization of

those who are perceived as not pulling their weight. By creating an environment of fear, the organization expects the current workforce to become more efficient in their work habits (Tursman 33).

Short-term stock gains

Layoffs have become the change tactic of choice for several compelling reasons. Short-term stock gains look good to the investors and the investors view the layoff as a sign of a corporate turnaround. Yet like the other pseudo-benefits of a layoff, any upturn in stock price is short-lived (Brigham 33). A Mitchell & Co. study of 16 major firms that cut more than ten percent of their workforce between 1982 and 1988 found that although Wall Street initially applauded the cuts with higher stock prices, two years later 10 of the 16 stocks were trading below the stock market by 17 to 48 percent. Worse, 12 of these companies were trading below comparable firms in their industries (Tursman 32).

Enhance organizational effectiveness

Many companies are successful if they truly reengineer the work and define better processes and ways of doing their work. Reengineering is not restructuring or downsizing. Reengineering, means doing more with less and beginning again with a clean sheet of paper. It is about rejecting the conventional wisdom and received assumptions of the past.

Reengineering is about inventing new approaches to process structure that bear little or no resemblance to those of previous eras if indeed a new way is better. The key to reengineering is to look at the way the work is done and not just to cut people without reengineering the work (Champy 58).

Arguments Opposed to Downsizing

While downsizing rages through the US economy, there is a great deal of uncertainty about its bottom-line effects. This uncertainty raises questions about why corporations have been so eager to engage in downsizing. Three social forces frequently provide a major impetus for downsizing. Constraining forces pressure organizations to conform to institutional rules that define legitimate structures and management activities. Cloning forces pressure organizations to mimic the actions of the most prestigious, visible members of their industry. Learning forces emerge through management practices taught in universities or professional associations throughout the corporate world. In all of these scenarios, downsizing is considered an attractive quality. Managers should be aware that many reasons to downsize are strictly social, and could hurt their companies in the long run. Downsizing seems to go beyond a mere fad. It has become part of a continuing longer-term aspect of social and economic evolution (Brockner 329).

Many major companies are restructuring. IBM has downsized over the last few years, and has noticed negative results in their stock-prices and financial performance over the long term. IBM's corporate rating dropped from a triple-A credit rating to double-A-minus. The drop in credit rating reflects the lack of confidence in the management's ability to reposition for the future (Bergmann 511).

Eastman Kodak has also restructured over the last few years, and has experienced negative stock results over the long term. The profit margins are lower and the stock prices have not improved since the downsizing efforts. Although the company effected layoffs in response to poor corporate performance, it did little to help the bottom line (Bergmann 511).

Some of the strongest evidence condemning layoffs comes from Wyatt Company. A survey of 1,005 corporations that had recently participated in a downsizing program found the following:

1. Only one-third of the corporations said that profits increased as much as they had expected after the layoff.
2. Fewer than half said that their cuts had reduced expenses as much as expected over time --an understandable result, considering that four out of five of these same managers reported rehiring for the positions that were laid off.

3. Only a small minority reported a satisfactory increase in shareholders' return on investment as a result of the layoff (Reich 54).

A series of studies conduced by the American Management Association concluded that two words sum up the ineffectiveness of layoffs: poor management. First, they found that long-range planning before a layoff was the exception, not the rule. Executives often view future costs to be predictable and future revenues as less so. Thus, they focus on cost reduction rather than increasing revenues. So in a twisted way, a layoff becomes a plan for the future -- a way: to reduce the only sure thing about future: costs (Reich 54).

Additional AMA research has found that 60 percent of the companies that laid off employees in 1992 also laid off employees in 1993. In a 1994 AMA study, two-thirds of the companies that laid off also reported hiring new employees in other areas. When you combine this with the Wyatt Company finding that most laid-off positions are filled within two years, a binge-and-purge picture begins to emerge. With a watchful eye to quarterly results, company management opens and closes the hiring gate according to short-term financials, not long-term business needs. Staff up when things look good, in other words, and lay off when they start to slip. Moreover, this cycle that perpetuates and feeds itself is a very expensive process. Dow Chemical estimates that the cost of

rehiring a single technical or managerial employee is as much as $50,000 (Boroughs 51).

Table 1. Arguments Favoring Corporate Downsizing

Arguments
• Reduces operating (labor) costs
• Eliminates unneeded tiers of management
• More responsive to customers
• Enhances communication process
• Expedites decision making process
• Creates more employee involvement
• Faster product development
• Streamlines corporate operations
• Permits company to "prune" employee deadwood
• Enhances organizational effectiveness
• Makes company more globally competitive

Source: Bergmann, Thomas J., Kenneth P. De Meuse, and Paul A. Vanderheiden. "Announced Layoffs: Their Effect on Corporate Financial Performance." Human Resource Management 33 (1994): 513.

Table 2. Arguments Opposed to Downsizing

Arguments
• Fails to significantly improve corporate performance
• Lower product quality and productivity because employees feel betrayed, angry, frightened, and confused
• Decreases profitability and slows dividend growth
• Drops stock price due to perception company is in financial trouble
• Lowers morale and job satisfaction resulting in higher tardiness, absenteeism, and turnover
• Increases employee work loads
• Increases employee stress resulting in increased health care expenses
• Reduces company loyalty and commitment which may lead to higher turnover and employee law suits of unjust discharge
• Depletes employee experience and skills base in a company
• Necessitates outplacement costs and severance pay agreements
• Strains labor union relations due to mistrust, paranoia, and miscommunication
• Strains community relations due to negative publicity
• Overall costs outweigh benefits

Source: Bergmann, Thomas J., Kenneth P. De Meuse, and Paul A. Vanderheiden. "Announced Layoffs: Their Effect on Corporate Financial Performance." Human Resource Management 33 (1994): 513.

Kenneth De Meuse, professor at University of Wisconsin, studied the aftermath of large announced layoffs. He concluded that large layoffs did not automatically improve financial performance (Reich 54). In the study, conducted by De Meuse, Vanderheiden, and Bergmann, the following five measures of financial performance were tracked over a five year period: (a) profit margin on sales, (b) return on assets, c) return on equity, (d) sales to total assets, and (e) the ratio of market-to-book value of equity (Bergmann 512).

The financial performance of Fortune 100 companies was tracked over a five-year period: 1987 - 1991. *Workplace Trends* was the source for the layoff announcements and financial data was collected from *Fortune Magazine's* annual survey of the 500 U.S. industrial corporations with the largest reported sales, known as the "The Fortune 500." Studies contrasted the financial performance of the companies that announced layoffs versus companies that made no layoff announcements during the same period. The announced layoffs as a percentage of total employees, served as the independent variable. Performance was tracked two years before the announced layoff, the year of the layoff announcement and two years following the announcement. The study also contrasted profit margin, return on assets, return on equity, asset turnover, and market-to-book ratio. Results show financial performance declined after the announced layoffs (Bergmann 514).

Table 3. Fortune 100 Companies Used in Study

Boeing	Honeywell
Campbell Soup	IBM
Champion International	Lockheed
Chrysler	Motorola
Digital Equipment Corporation	Occidental Petroleum
Eastman Kodak	Texas Instruments
General Electric	UNISYS
General Motors	Unocal
Hewlett-Packard	

Source: Bergmann, Thomas J., Kenneth P. De Meuse, and Paul. A. Vanderheiden. "Announced Layoffs: Their Effect on Corporate Financial Performance." Human Resource Management 33 (1994): 515.

Table 4. Changes in Financial Performance of Companies with 1989 Announcements

Performance Measure	1 Year Before	1989	1 Year After	2 Years After
Profit Margin	-.02	-.29	.14	-.29
Return on Assets (ROA)	-.04	-.22	.11	-.26
Return on Equity (ROE)	-.16	-.23	.03	-.37
Asset Efficiency	-.08	-.05	-.10	.03
Market-to-Book Ratio	-.21	.17	.05	.07

Source: Bergmann, Thomas J., Kenneth P. De Meuse, and Paul A. Vanderheiden. "Announced Layoffs: Their Effect on Corporate Financial Performance." Human Resource Management 33 (1994): 517.

The statistical tests reveal no significant positive relationships for any of the financial variables over the four years. In the year of the announcement (1989), only the change in profit margin shows a significant relationship to layoff announcements. Consequently, the larger the layoff the bigger the decline in profit margin compared to the year before the announcement. For ROA and ROE, there are similar declines but they are not statistically significant (Bergmann 517).

Decreased Financial Performance

The results show announced layoffs decrease financial performance. The performance continues to decline following the announcement and at a greater degree than firms that had no layoff announcements. Companies turn to layoffs when they are unable to solve fundamental problems. The American Management Association predicts 63 percent of all companies that downsized will downsize again. Profits do not improve because companies repeat the cycle and start hiring again without restructuring the remaining work (Lesley 101).

Table 5. Mean Values of Financial Performance Measures for No-Layoff and Announced Layoff Companies

Performance Measure	1987	1988	1989	1990	1991
Profit Margin					
-No Layoff	.06	.06	.07	.06	.05
-Layoff	.06	.06	.04*	.02**	.00**
ROA					
-No Layoff	.07	.07	.08	.07	.06
-Layoff	.06	.06	.04*	.02**	.01**
ROE					
-No Layoff	.16	.23	.22	.20	.15
-Layoff	.14	.13**	.10**	.05**	-.01**
Asset Efficiency					
-No Layoff	1.25	1.24	1.20	1.20	1.13
-Layoff	1.13	1.05	1.06	1.08	1.03
Market-to Book					
-No Layoff	2.63	2.64	2.87	3.44	3.50
-Layoff	1.74*	1.62**	1.69**	1.83**	1.84*

Note: Figures were rounded off to two decimal places

N = 35: Fortune 100 Companies which made no layoff announcements during 1989
N = 17: Fortune 100 Companies which made a layoff announcement during 1989
*$p < .05$ **$p < .01$

Source: Bergmann, Thomas J., Kenneth P. De Meuse, and Paul A. Vanderheiden. "Announced Layoffs: Their Effect on Corporate Financial Performance." Human Resource Management 33 (1994): 518.

Reduction in Productivity and Morale

Frederick Herzberg developed a two-factor theory, to define what factors motivate employees. He believes employee behavior is influenced by motivation and hygiene factors. His studies indicate certain factors at work motivate people, while other factors did not motivate. The motivational factors address higher level needs of workers and have to do with the content of jobs, such as: challenging work, opportunity for growth and advancement, and recognition. Hygiene factors address lower level needs of the employee and include: working conditions, pay, interpersonal relationships, and company policies (Smith 41). According to Herzberg's theory of motivation, money does not motivate employees and displaced employees view severance pay as hygiene factors.

Downsizing's effect on the office environment may not be so healthy. Organizations have a lot fewer people doing all the work that was done before and the people are stressed out and overworked. Generally they are doing the jobs of two or three people, working long hours with no time at home. Generally, the organization does not look at the systems or the methods and procedures used to do the tasks before downsizing. In many cases, the boss does not know what the staff is doing and what needs to be done to improve the efficiency of the office. It is no surprise that productivity and morale decline (Downs 158).

Organizations need to access the wealth of resources hidden within their workforce. Human Resource managers can play a larger role in helping corporations resolve five basic weakness that hamper competitiveness. Employee commitment is underdeveloped. Employees do not know what is expected of them and are not encouraged to try new ways of doing business. Managing employee skills and intellectual assets receives little attention in most organizations. Most workers are not stimulated or are afraid to try something new, for fear of job loss. Links between employees in different business units are not developed and exploited. We typically do not explore outside our own business units which limits our creativity and imagination (Feldman 50).

Employees taking on additional responsibilities can become very stressed if they do not feel adequately trained for their additional assignments. They might not have any experience or training in the new job areas. Most downsizing companies experience higher operational costs due to stress related issues. Studies show a direct link between stress and employee counter productivity. Worker stress often reveals them in the forms of absenteeism, chronic lateness, low morale, illicit-drug or alcohol abuse, theft, and in extreme cases, on-the-job violence. Excessive and chronic stress can also lead to health problems, adding to a company's costs (Gordon 99).

One major area of study has been career development within flatter organizations. The first stage of this research examined how to retain and motivate employees whose career progression and work patterns are affected by changing organizational and work structures. Some disturbing trends were discovered. Three-quarters of those surveyed said that delayering had increased their workload and lowered their morale. The main reason for lower morale was the reduction in promotion prospects. On the positive side, people reported an increase in teamwork but it was clear that, in many organizations, flexibility was still a long way off (Levine 253).

A link was found between the reason for the delayering and the level of morale. If people believed there was a genuine strategic goal, such as developing global markets, they saw the effects of the new structures to be less negative than if they thought delayering had occurred purely to cut costs. This first stage highlighted the value of communication in enabling employees to adjust to new structures and to develop a new career concept (Levine 256).

Customer Dissatisfaction

Despite warnings about downsizing becoming dumbsizing, many companies continue to make flawed decisions--hasty, across-the-board cuts-- that come back to haunt them, on the bottom line, in public

relations, in strained relationships with customers and suppliers, and in demoralized employees. Sweeping early-retirement and buyout programs sometimes eliminate not only the deadwood but the talented, many of whom head straight to competitors. Meanwhile, many replacements arrive knowing little about the company and soon repeat their predecessors' mistakes (Madrick 32).

Cost cutting has become the motto of corporate management, but what helps the financial statement up front can and end up hurting it down the road. In Digital Equipment Corporations 1994 reorganization, the company eliminated hundreds of sales and marketing jobs in its health-industries group, which had been bringing in $800 million of annual revenue by selling computers to hospitals and other health-care providers world-wide. Digital says it cut because it had to act fast. It was losing about $3 million a day, and its cost of sales was much higher than that of its rivals (Frame 34).

But in the health-industries group, the cutbacks imposed unexpected costs. Digital disrupted long-standing ties between its veteran salespeople and major customers by transferring their accounts to new sales divisions. Resellers of Digital computers, who account for most of its health-care sales, also complained about diminished technology and sales support. Many Digital customers turned to International Business

Machines Corporation and Hewlett-Packard Company, and so did some employees of Digital's downsized healthcare group (Downs 190).

Another set of downsizing problems arose after Kohlberg Krawis Roberts & Company's 1989 leveraged buyout of RJR Nabisco Corporation. Under KKR, debt burdened RJR Nabisco's divisions came under pressure to slash costs and improve profit margins. A herd of consultants were brought in, and they recommended merging the sales force of Nabisco Foods, which makes such products as Grey Poupon Mustard and Milkbone dog biscuits, with that of Planters & LifeSavers Company, which makes its trademark candies, nuts and other confections (Gombola 32).

The problem was the two businesses had very different products and sold to very different markets. Nabisco mostly supplies groceries and supermarkets; Planters mostly sells to smaller outlets, including drugstores and convenience stores. Sales representatives generally cannot push mustard, dog bones and candy and they have distinctly different outlets. Without adequate sales representation, Planters lost sales and buyers felt abandoned. The buyers had new salespeople calling on them and there was no established relationship and this put them at a competitive disadvantage (Gombola 33).

Sometimes even small cutbacks backfire. Continental Airlines stopped carrying aspirin on its flights and the move would save only

$20,000 a year, but a few such savings added together, the airline figured, would start to bolster the bottom line. After a while, however, Continental noticed that callers to its customer hotline were griping about the lack of aspirin. In addition, flight attendants said passengers needed headache relief. A new chief executive made reversing that error one of his first moves and decided to listen to the customers instead of focusing so heavily on costs (Jennings 74).

Other companies try to reduce employment costs by replacing experienced veterans with less expensive contract workers. But that can heighten a company's chances of being represented by people who perform poorly--or worse. That is what happened at Peoples Natural Gas Company, which hoped to save more than $1 million last year by replacing its 35 meter readers with contract workers. The company did not get the same quality by outsourcing as they would with their own employees (Cascio 98).

Cutbacks that result in poor customer service can also lead to hefty penalties. Nynex Corporation recently was ordered by New York's Public Service Commission to rebate $50 million to customers because its reduced staff fell behind in responding to problems. Nynex's early-out programs for managers and craft-level employees, which have trimmed about 12,000 jobs since 1993, have caused labor shortages as well. Nynex has hired back hundreds of former employees, including managers

already receiving pensions. A Nynex spokesman acknowledges that customer service has suffered from the cutbacks and says the company is now hiring hundreds of workers to improve it (Rugman 78).

Negative Investor Reaction

Worrell, Davidson and Sharma, investment analysts, studied 194 companies that announced layoffs between 1979 and 1987. Studies show that stock prices were negatively related to announced layoffs, and the announcements did not help the financial performance of the company. Gombola and Tsetsekos studied and tracked 982 companies that announced layoffs in a plant environment. The announcements were followed by negative stock price reactions and lower financial performance (Bergmann 511).

The corporation must also decide how to deal with the surviving employees. Generally, the employees express their displeasure by pushing morale to all-time lows and complaints of stress-related illnesses and absenteeism rise dramatically (Ansof 12). Also, the survivors must pick up the workload of the employees who were let go and all workers are pushed to work harder and longer to make up for the lost productivity. If a reduction-in-force (RIF) is necessary, then research suggests that the methods by which massive layoffs are implemented may substantially

affect the performance of employees who are about to lose their jobs, as well as that of employees who survive the current round of layoffs (Collins 25).

Surviving employee reaction

Surviving employees experience similar feelings when their jobs are eliminated and nothing is done to deal with their feelings. Many companies provide outplacement for the displaced employees and do not provide any support or time for the surviving employees. People need and want to say goodbye to their friends and co-workers. They should also be treated with respect and not humiliated in front of their co-workers, not escorted out the door by a security guard. Employers can assume that displaced employees are not automatically out to sabotage the organization. Employers need to let the employees feel they still have their dignity (Noer 26).

The remaining employees will pay close attention to the way the downsized employees are treated. The company can also make sure the remaining employees know the way the new organization is managed. Companies can respond to their remaining employees' emotional and career development needs and decide the speed at which a business bounces back from downsizing. Companies that reported improvements in their employees' attitudes and capabilities after downsizing were the

ones that made a comprehensive commitment to being available to be supportive of their survivors. An organization must anticipate and plan to address the loss of morale and loss of trust in management that exists in the wake of downsizing. Negative feelings will only fester and hinder employees from moving forward.

The loss of a job is a devastating experience for most people. Their identity is gone, as well as their self-esteem and financial support system. An analogy of the devastation is to relate the situation to the family. The family consists of a mother, father and four children. Every day the family meets for breakfast and discusses the events of the day, similar to an organizational staff meeting (Neinstedt 155).

One day, the children sense there is something wrong and sense a great deal of tension between the parents. Finally the mother speaks and tells the children they do not have enough money to make ends meet. She avoids eye contact with the children and stares at the piece of paper in her hands. After she regains her composure, she points to two of the children and tells them they must go. It is nothing personal, but we just cannot afford to feed and clothe you because we don't have enough money. The children remain silent while the mother passes copies of the family budget to each child. The father tells the displaced children they will be staying with their aunt and uncle (Neinstedt 156).

The next morning the remaining children sit down with the parents for breakfast and look at the table with only four places. Two chairs have been removed. The children's personal belongings are gone and no one talks about the two children that have disappeared. The parents emphasize to the remaining children, the survivors, they should feel very grateful since they are still in the family. Since the workload will increase, we will be expected to work harder to get the chores done. Remember to eat your breakfast since the food costs a lot of money and we are on a tight budget (Neinstedt 155).

Many employees feel they are part of a family in their organization. Although the above scenario is somewhat melodramatic, employees need attention and comfort as well as the displaced employees. People need a chance to say goodbye and to find closure with the situation (Worrell 665).

Statement of Hypothesis

Downsizing, re-engineering, delayering, or whatever one might like to call it is probably inevitable, and may well be a good thing in some cases. However the results presented in this study do not support the contention that layoffs serve to improve, or even stem the decline in financial performance. Generally the performance continues to decline following the layoff announcement and at a greater degree than firms which had no layoff announcements. Since one of the key reasons given

for downsizing is to strengthen a firm's financial performance, the results presented in this study do not support this rationale. Evidence suggests that firms that layoff employees continue to perform much more poorly than do other companies.

The findings of the present study strongly show (a) financial performance continues to lag and (b) more layoffs probably will occur. Generally downsizing is more likely to be effective when it is part of an organization's overall long-term strategic planning process.

Chapter III

Research Methodology

Subjects

This study analyzed the financial performance of corporations undergoing reductions in labor force. A hypothesis has been suggested that companies undergoing layoffs in work force suffer reductions in financial performance. Therefore access to public information on financial performance was required to support the hypothesis. Comparisons were made between those companies undergoing layoffs and companies not undergoing layoffs. The metrics considered for analysis included the following:

- Profit Margin
- Return on Assets (ROA)
- Return on Equity (ROE)
- Sales/Assets
- Price Earnings Ratio
- Profits per Employee
- Sales per Employee
- Relative changes in workforce

Profit margin is a measure of the profitability of an organization and therefore its efficiency of operations. Profit Margin is calculated as the profit after taxes as a percentage of sales. If costs drop as a result of reduced labor costs profit margin will increase, assuming sales remain stable. Return on Assets (ROA) is a measure of the corporation's return on invested capital whether it is debt or equity. Return on Assets is an indicator of the overall return on invested capital and therefore a measure of the efficiency of management's use of capital allocation. A decrease in the ROA of a company undergoing layoffs would indicate that either sales are remaining constant and compensating investments have been made in machinery or sales are also declining (Siegel 268).

Return on Equity (ROE) is a measure of the return to stockholders of the firm. From the perspective of those whose capital has been invested in a particular firm as an alternative to competing investments, ROE is the fundamental measure of performance. The ratio of Sales to Assets is a measure of how efficiently management is using its assets to generate revenue. If a reduction in workforce is undertaken and it results in a more efficient use of assets the ratio will increase. Alternatively, if after reducing its workforce the generation of sales begins to decline, this ratio will decrease indicating a decreasing efficiency in the use of assets. The Price Earnings Ratio is an indicator of investor's future expectations

of a firm's ability to operate profitably. Stock price is a reflection of an investors desire to purchase the earning power of a corporation. If the price of a stock is high relative to its earnings it is an indication that investors expectations are of increased future earnings. Alternatively, a drop in the ratio of price to earnings indicates investors lack of sentiment that future earnings will improve (Brealey 53).

Profits per Employee is a measure of productivity in terms of the efficiency of use of human capital. If a reduction in workforce results in an increase in the relative efficiency of employees then the profitability of the firm with respect to efficient use of human capital will improve. Sales per Employee is a measure of the revenue generation of the corporation relative to the size of the workforce. A reduction in workforce should result in the ratio of Sales per Employee increasing. An increase in the ratio of Sales per Employee without an equivalent increase in the ratio of Profits per Employee indicates that while human capital costs have been reduced the efficiency of the corporation in generating a return on assets has not improved (Siegel 283).

The subject companies were extracted from the Fortune 100 listing. While early considerations for this study focused on a sample population made up of Fortune 500 medical companies, extensive investigation using Standard Industry Codes (SIC) for market segmentation revealed a population too limited from which to draw any

conclusions. Therefore the analysis was expanded to include large companies as defined by the Fortune 100. These companies represent a range of industries. It is recognized that average values for financial measures vary significantly across industries. As an example, the expectation for ROE in the utility industry is significantly lower than that in the pharmaceutical industry. This is a reflection of investor's expectation of return in compensation for differences in risk. This discrepancy across industries precludes direct comparisons between companies. However, this study attempts to circumvent this issue by considering a sample population and reviewing the changes in each of the targeted financial measures from year to year. This study considers the relative performance of the indicated financial measures from year to year in an environment of force reduction.

Comparisons are made between those firms announcing layoffs and those not announcing layoffs in 1989. The information collected focuses on the relative performance from year to year of a group of corporations identified as announcing layoffs versus a group that underwent no layoffs. The time period includes the year of the layoff announcements, two years prior to the announcement and four years following the announcement.

The establishment of a basis for comparison to pre-layoff performance can be done in two years. The process of downsizing may

take several years during which the Price to Earnings ratio will reflect short term expectations of the results of downsizing. A period of four years from the announced layoffs should capture the longer term actual impact on performance as reflected in Return on Equity. Therefore the time period studied will be seven years - two years before the announcement, the year of the announcement and four years after the announcement.

Instrument

Sources used for determining the target population and collecting the financial information on the selected companies included the 1997 Wards Business Directory of U.S. Private and Public Companies which lists companies by SIC code, the annual survey of the largest 500 U.S industrial corporations conducted by Fortune Magazine, and a similar study performed annually by Forbes magazine. Layoff announcements were identified by Workplace Trends as reported in the Study conducted by Bergmann, DeMeuse, and Vanderheiden. The Fortune 500 was used to collect statistics on Profit Margin, Return on Assets, and Return on Equity. The Forbes 500 was used to collect statistics on the Price Earnings Ratio, Profits per Employee, Sales per Employee, and the number of Employees.

The source Workplace Trends identified 17 companies that underwent layoffs in 1989 and 83 companies that did not. The number of companies not undergoing layoffs was reduced by a further 48 that did announce layoffs in subsequent years. A still further reduction resulted from the elimination of firms with incomplete financial information. The final sample included 16 companies that had announced layoffs and 33 companies that had not announced layoffs for a total of 49 companies.

Procedure

Information on the targeted 49 companies representing the eight measures of financial performance, Profit Margin, Return on Assets (ROA), Return on Equity (ROE), Sales/Assets, Price Earnings Ratio, Profits per Employee, Sales per Employee and Relative changes in workforce were extracted from the Fortune 500 and Forbes 500 issues for the years 1987 through 1993.

The following table identifies the companies studied:

Companies Selected for Comparison of Financial Performance

Layoffs	No layoffs	
General Motors	Mobile	Merck
IBM	Phillip Morris	ADM
General Electric	Texaco	American Brands
Chrysler	Proctor & Gamble	Ralston Purina
Boeing	Pepsico	Borden
Eastman Kodak	Conagra	General Mills
Hewlett-Packard	Dow Chemical	Pfizer
Digital Equipment	Minnesota Mining & Mfg.	American Home Products
Motorola	Phillips Petroleum	W.R. Grace
Occidental Petroleum	Coca-Cola	Abbott Laboratories
Unocal	Georgia-Pacific	Kimberly-Clark
Unisys	Catepillar	Amerada Hess
Texas Instruments	Aluminum Co. of America	LTV
Campbell Soup	Coastal	Quaker Oats
Lockheed	Ashland Oil	Reynolds Metal
Honeywell	Weyerhaeuser	PPG Industries
	Stone Container	

Note: 16 companies announced layoffs, 33 companies announced no layoffs.

Source: Bergmann, Thomas J., Kenneth P. DeMeuse, and Paul A. Vanderheiden. "Announced Layoffs: Their Effect on Corporate Financial Performance." Human Resource Management 33 (1994): 515.

Data Analysis

The financial performance information collected was incorporated into multiple spread sheets for calculation of means, medians, standard deviations and variances. The results of data consolidation for the companies that announced layoffs and the companies that did not undergo layoffs were graphed for comparison and interpretation.

Because this study is observing relative changes in financial performance measures for the selected companies, it considers the change in a measure from one year to the next relative to the first year. In other words for understanding the effect on Profits per Employee as a result of layoffs in 1989 the relative change in Profits per employee for the years 1989 to 1990 is compared to that of 1989 [Profits per Employee (1990-1989/1989)]. This approach is extended additional years to look for lags in the effects of layoffs on the financial measures of interest.

A similar approach was incorporated in the study "Announced Layoffs: Their Effect on Corporate Financial Performance" by DeMeuse, Vanderheiden, and Bergmann. However, this study goes further by extending the analysis to include a number of additional financial performance measures including the Price Earnings Ratio, Profits per Employee, and Sales per Employee. Inclusion of the Price Earnings Ratio gives visibility to investors short term reaction to the information content of a layoff announcement. The measure of Profits and Sales per Employee

indicates the productivity of human capital and can be used as a surrogate for the potential impact layoff announcements have on employee morale which translates into productivity. In addition this analysis considers the effects on financial performance for an extended period of four years from the time of layoff announcements.

Chapter IV

RESULTS

The table below presents the mean values for the eight financial performance measures of the two groups of companies, layoff and no-layoff. The figures indicate that financial performance as measured by Profit Margin, Return on Assets, and Return on Equity for 1987, two years prior to the 1989 layoff announcements, did not vary significantly between the two groups. However, the productivity of human capital was higher in terms of Profits per Employee and Sales per Employee for the group of companies with no layoffs than for those who would eventually announce layoffs in 1989.

Mean Values of Financial Performance Measures for No-Layoff and Announced Layoff Companies

		Profit Margin	ROA	ROE	Sales/ Assets	P/E	Profits/ Empoyee	Sales/ Employee	Number of Employees
1987	Layoffs	5.8	6.3	14.0	1.1	15.4	$6,762	$116,586	167,806
	No-Layoffs	5.8	6.8	15.9	1.2	14.6	$9,300	$160,345	50,190
1988	Layoffs	5.7	5.6	13.9	1.0	11.1	$6,525	$114,474	165,000
	No-Layoffs	6.1	6.7	23.4	1.1	12.1	$16,550	$271,311	49,881
1989	Layoffs	3.3	3.5	9.8	1.1	16.5	$5,369	$162,083	164,400
	No-Layoffs	7.4	8.2	22.9	1.1	13.0	$19,715	$266,092	52,925
1990	Layoffs	3.7	3.8	8.4	1.0	16.9	$3,300	$162,326	161,400
	No-Layoffs	4.3	4.8	13.8	1.2	15.6	$17,400	$271,852	56,700
1991	Layoffs	0.1	0.7	-19.0	1.1	22.8	$1,700	$186,386	154,600
	No-Layoffs	5.3	6.1	16.2	1.1	21.3	$13,900	$285,791	57,900
1992	Layoffs	-0.6	-0.1	-21.1	1.1	21.8	$1,762	$193,037	152,200
	No-Layoffs	2.8	3.4	4.1	1.1	21.2	$14,000	$309,713	59,800
1993	Layoffs	1.6	1.8	4.2	1.1	18.4	$8,200	$183,301	138,800
	No-Layoffs	7.4	7.5	38.1	1.1	19.3	$10,800	$326,674	59,400

For 1988, one year prior to layoffs, the Profit Margin and ROA were relatively similar between the two groups. However, the ROE was now 68% higher than that of the group that would announce layoffs one year later. The human capital productivity gap had also widened from the 37% in 1987, to 155% in 1988.

The year of layoffs demonstrates a significant departure in financial performance between the two groups. Performance for the group that does not announce layoffs is superior by 124% in Profit Margin, 134% in ROA, 133% in ROE, and 265% in Profits per Employee. In stark contrast, while Price/Earnings ratios were relatively similar in the two prior years, in the year of layoffs the group of companies announcing layoffs experienced a considerable upward movement. This differentiation continued although narrowing until 1992 at which point P/E ratios for the two groups again became similar. Although the group of companies announcing layoffs experienced a higher market valuation than the no-layoff group of companies for the four years subsequent to the layoffs, as reflected by the Price/Earnings ratio, this group continued to demonstrate considerably worse financial performance.

Figures 1 through 8 graphically illustrate the performance of each group of companies over the seven year period. Figure 1 indicates that in the year of layoffs Profit Margins for the group with no layoffs departed sharply from the group announcing layoffs and throughout the study period remained superior. Figure 2 illustrates a similar relative

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performance relationship between ROA and the announcement of layoffs. Figure 3 graphs the long term financial performance metric ROE. While ROE for the layoff group is below that of the no layoff group it is not until 1989, two years beyond the date of layoffs that the layoff group experiences a significant relative drop in ROE. This measure begins to rise again in 1992 but does not close the gap with the no-layoff group.

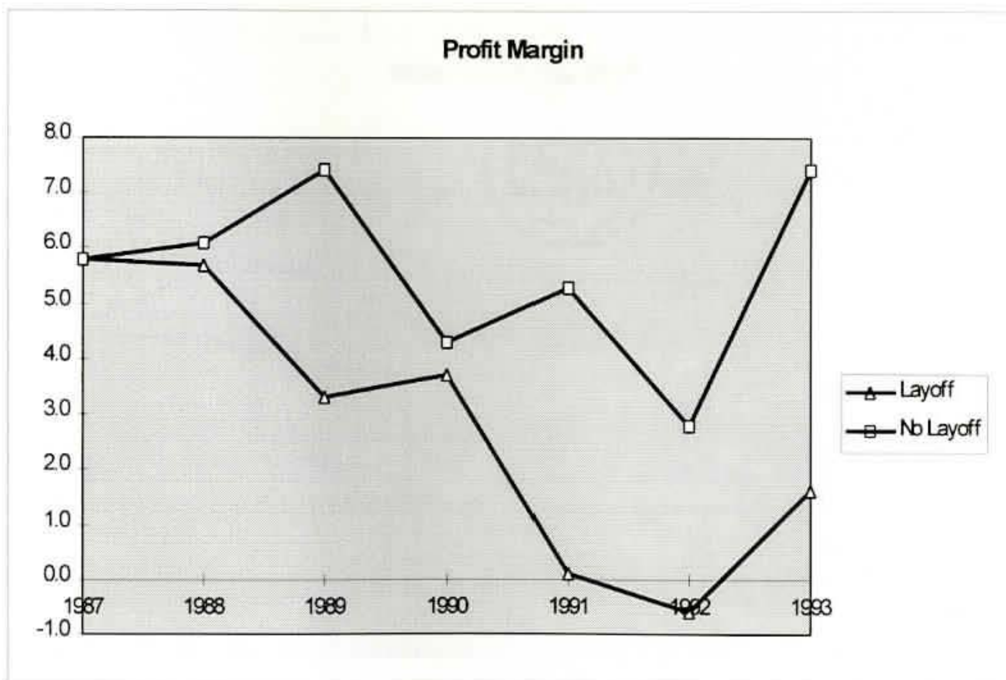
Figure 4 indicates that the ratio of Sales to Assets remains relatively stable throughout the study period. As discussed, Figure 5 indicates that the layoff group experienced a significant jump in the short term financial measure Price/Earnings ratio in the year that layoffs were announced. Figure 6 plots the human productivity measure Profits per Employee.

Those companies not undergoing layoffs demonstrated a higher measure of human capital productivity throughout the study period. This gap expanded to it widest point in the year layoffs were announced and only began to close in 1993, four years after the announced layoffs. For the four years subsequent to the announced layoffs the no layoff company's employee productivity, in terms of profitability, was higher by 265%, 427%, 718%, 677%, and 31% respectively. This information indicates a continuing decrease in productivity for those employees in companies undergoing downsizing.

Figure 7 illustrates the Sales per Employee. This measure indicates a higher level of sales per employee throughout the study period

with a significant jump in the differential in the year prior to announced layoffs. While the difference in this measure between the two groups narrowed in the year of layoffs, the difference in the measure Profits per Employee widened considerably. This indicates that while revenues per employee were stabilizing, costs per employee were increasing significantly. Figure 8 indicates that while the group of companies announcing layoffs in 1989 continued to reduce its overall employee base to approximately 83% of the pre-1989 number, the group of companies not announcing layoffs expanded its employee base to approximately 118% of the pre-1989 number.

Figure 1. Profit Margin



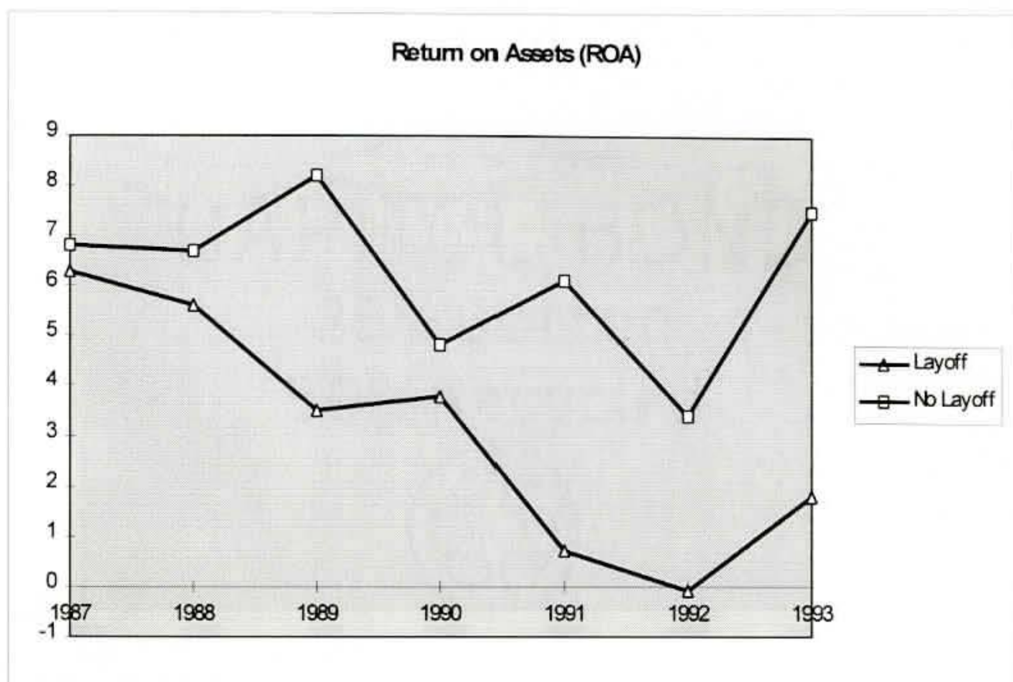


Figure 2. Return on Assets

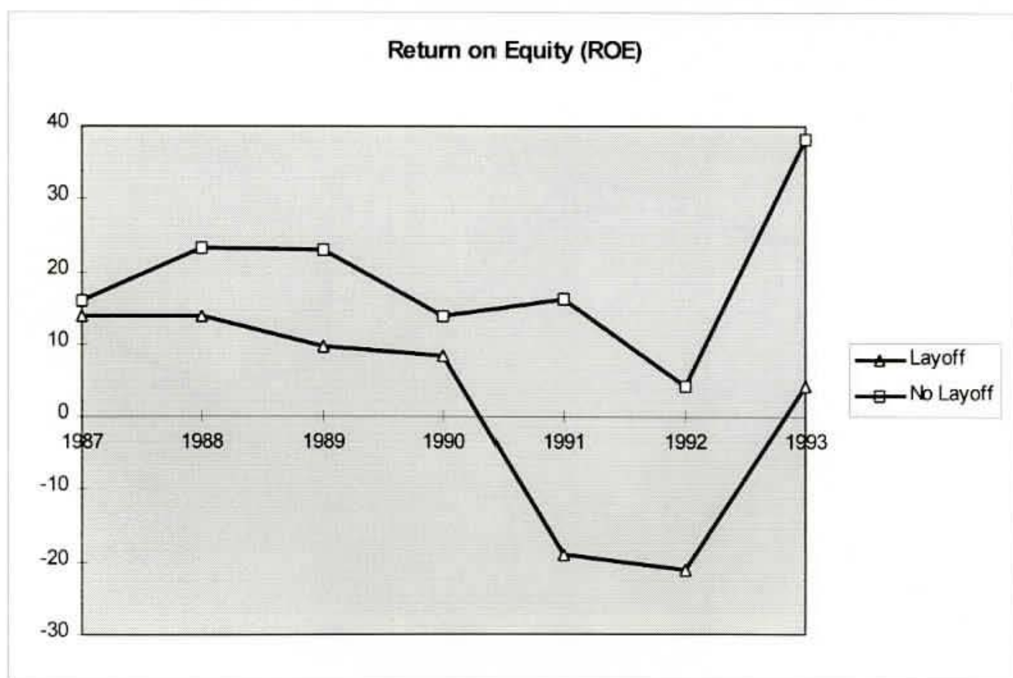


Figure 3. Return on Equity (ROE)

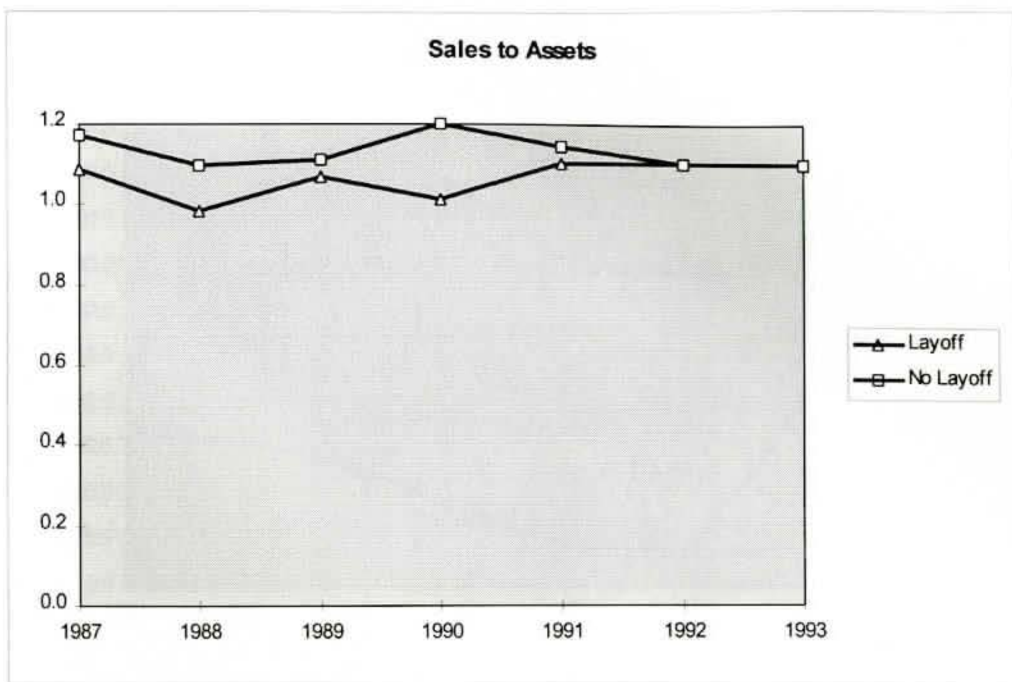


Figure 4. Sales to Assets

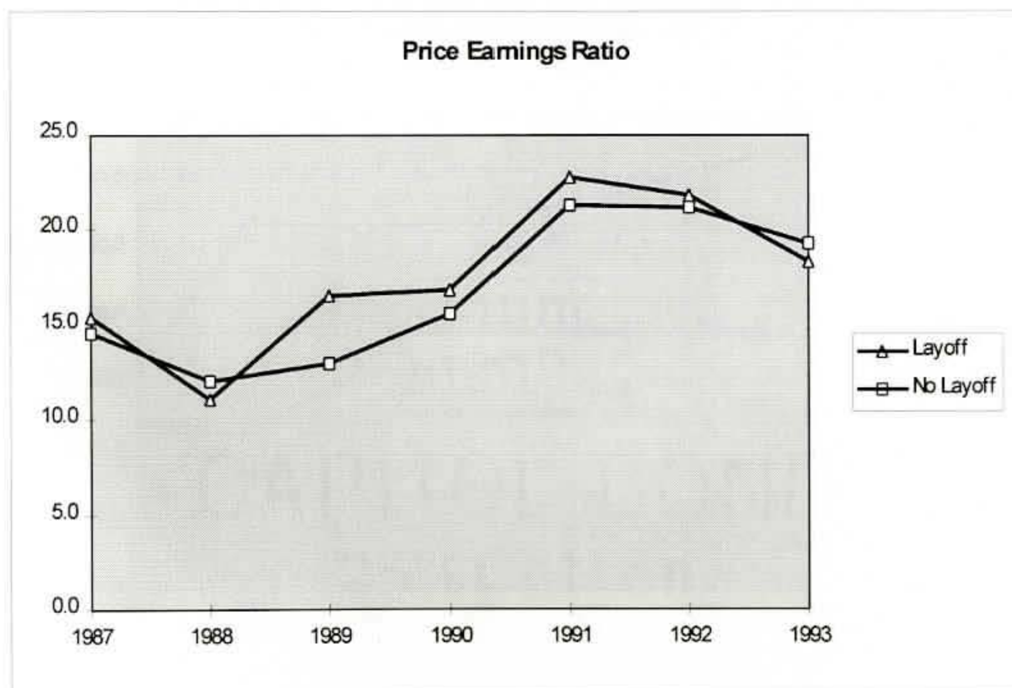


Figure 5. Price/Earnings Ratio

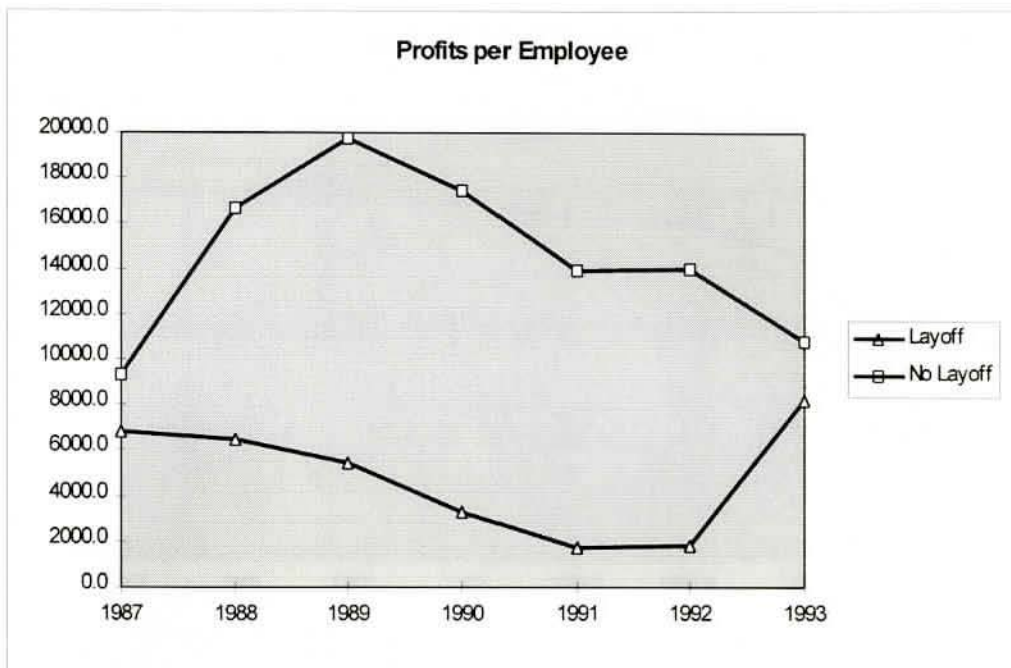


Figure 6. Profits per Employee

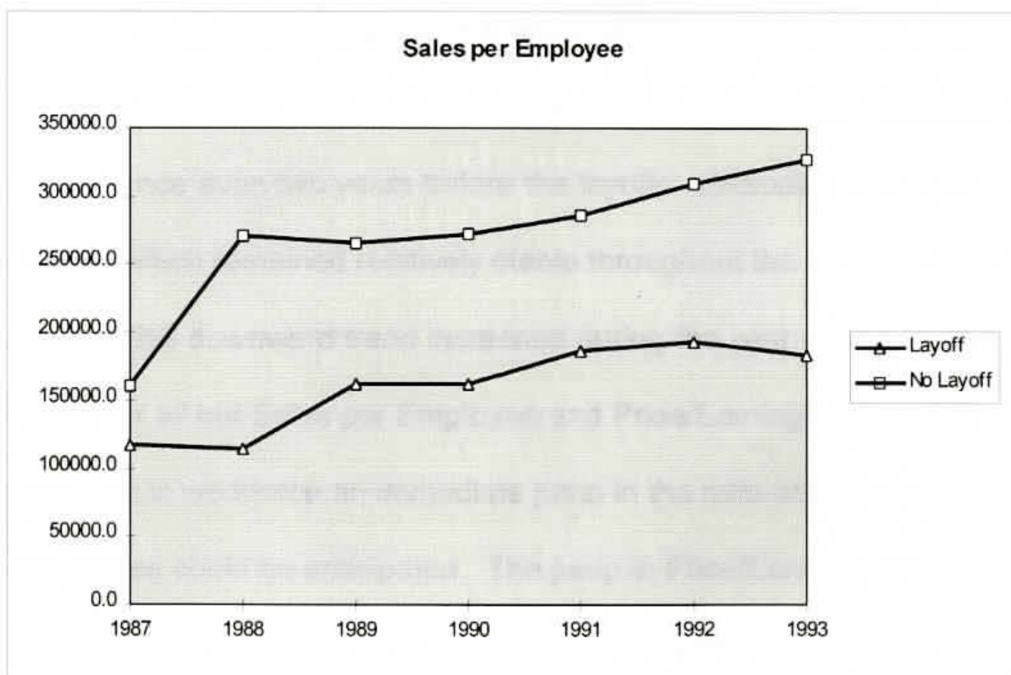


Figure 7. Sales per Employee

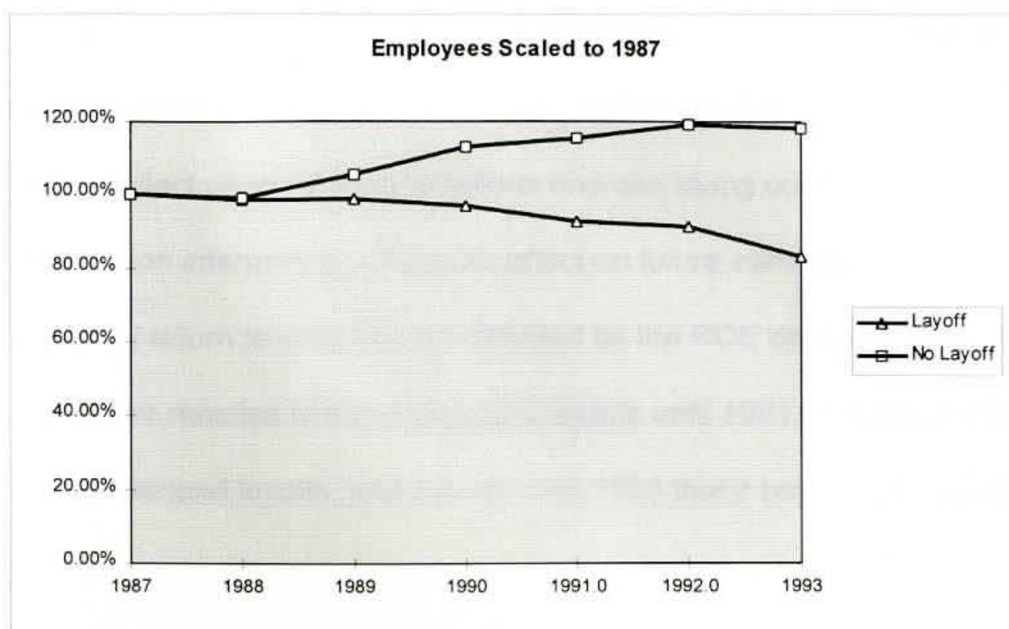


Figure 8. Employees Scaled to 1978

The results indicate that the group of companies announcing layoffs was experiencing a downward trend in most financial measures of performance even two years before the layoffs. Excluding Sales per Assets, which remained relatively stable throughout the study period, the slope of this downward trend increased during the year of announced layoffs for all but Sales per Employee and Price/Earnings ratio. With a reduction in workforce an immediate jump in the ratio of sales to employees could be anticipated. The jump in Price/Earnings ratio indicates a short term reaction by the market. With a reduction in employees the market perceives an immediate reduction in cost and a corresponding increase in profitability and projects this performance into

the future. Discounting this future performance back to the present results in an increase in the price of the stock relative to the earnings. Stock prices reflect short term expectations and can swing considerably on new information interpreted to have an effect on future earnings. The longer term real return to investors as reflected by the ROE does not indicate a significant reaction to the announced layoffs until 1991, two years after the announced layoffs, and it is not until 1993 that it begins to recover.

Chapter V

DISCUSSION

Summary

This study reviewed the comparative financial performance of two groups of companies over a seven year period. These two groups were defined by several characteristics: Fortune 100 companies with full financial information available for the seven year period of study; those Fortune 100 companies announcing layoffs in 1989; and those Fortune 100 companies not announcing layoffs in 1989 or in the years subsequent. These two groups of companies were compared via eight metrics for financial performance to assess whether the announcement of layoffs had a positive effect on the overall financial performance of the company.

Main Points

The results of the analysis indicate that over the long term the announcement of layoffs does not demonstrate any positive effect on the financial performance of a company. The population of companies announcing layoffs in 1989 was experiencing a downward trend in financial performance in the two years preceding the layoffs. Although the announcement of layoffs did have a significant positive effect on the

marketplace's valuation of the companies, there was no evidence of long term improvement in financial performance. The marketplace valuation as represented by Price/Earnings ratio is a measure of future expectations with limited relationship to current performance. The actual performance of this group of companies as represented by the ROE continued on a downward trend and experienced a marked further downturn two years past the layoffs.

Many companies undertake downsizing for the wrong reasons. The evidence does not support the contention that a reduction in workforce leads to a more profitable company. Some companies mistake "downsizing for "reengineering," rather than recognizing that downsizing should be considered a part of an overall reengineering effort. Some additional motivations for downsizing include pressure to lift the stock price and executive compensation plans with components driven by short term financial performance. The analysis conducted here indicates that the market does lift stock values with the announcement of layoffs. However, the long term stockholders and stakeholders derive no benefit from this short term market reaction. Few firms consider what they are trying to achieve by eliminating jobs.

Implications

The implications of the results of this study are several. Firms should undertake a more reasoned approach to reengineering. The evidence indicates merely reducing the cost of human capital through workforce reductions does not address the underlying imbalance of fundamentals. A careful analysis of what is fundamentally deficient with the performance of the corporation must be undertaken in the context of the many components of success. Bench marking should be considered as well as overall product placement strategy. Serious consideration should be given to incorporating long term performance incentives into the compensation plans of senior management. Often the results of corporate management's decisions can not be fully evaluated without the benefit of considering long term performance.

The hypothesis that downsizing may increase short term financial performance but does not increase long term financial performance is supported by the results of this analysis. The sample size is too small to state with confidence that the financial performance of the sample population was negatively impacted by layoffs. As a group the companies announcing layoffs were demonstrating declining performance prior to the layoffs. Furthermore, this study does not account for external factors that may be impacting the performance of the sample group such as currency valuations affecting those firms with international trade, recession, etc.

Alternatively, the firms represented in the sample groups constitute a cross section of industry and as a group provide some normalization of external factors that would affect one segment of the economy more strongly than others. It is therefore reasonable to conclude that the evidence indicates that a negative trend present in the sample group was not improved as a result of the reduction in costs of human capital, and that this trend increased in magnitude subsequent to layoffs even though short term market reactions boosted the price of the stocks. This evidence supports the hypothesis.

Suggestions for Alternatives

There is growing evidence that companies should stop using layoffs as a remedy for improved financial performance. Sometimes it is necessary to downsize in the organization. A company can use creative cutbacks to help cut costs in the organization without automatically eliminating staffing requirements. Some organizations use wage freezes to help reduce costs. Companies can also reduce salaries or implement hiring freezes to save jobs. Eliminating some executive perks or employee benefits might be more appropriate than a mass layoff. Employees must be seen as corporate assets, not labor costs to be minimized.

Reduction in pay

One method of reducing pay has been shown to work rather well in the short term. Instead of reducing pay across the board, the company ties the pay of its higher-paid managers and executives to overall company performance. If the company meets it financial objectives, the executives receive their full pay. If not, they receive a percentage of that pay dependent on the level of company performance.

Reduction in hours

Another technique, championed by the high-tech giant Hewlett-Packard, is the use of what HP internally called a "fortnight work schedule." That is, every two weeks (a fortnight) employees do not work for one day. When it was used during a slow sales period in August 1985, wages were cut ten percent. Combining these savings with shutting the non-sales offices down during the Thanksgiving and Christmas holidays not only saved additional payroll dollars but recouped a generous amount by closing the facilities. To help employees handle the loss in pay, the company allowed qualifying employees to use vacation days during the forced time off so that there was not immediate loss in pay. In Europe, the giant automobile maker Volkswagen has been climbing back to profitability after having put many of its 100,000 workers on a four-day

week. The company estimates that it has avoided laying off as many as 30,000 workers by using the reduced workweek.

Reducing hours is less demoralizing to morale than other alternatives because it plays to a sense of equity in the workers. Other methods of reduction seem to take something away and demand more, while this method takes something away but also requires less of the workers. The loss of pay may hurt, but the gained leisure time helps to remove the sting.

A related version of reducing hours, restricting overtime, can be an effective means of reducing payroll in businesses without a large hourly workforce. Since overtime is paid at a considerably higher rate than regular time, the savings can mount up quickly. This method comes with a caveat: Many companies restrict overtime and then look the other way as employees continue to work off the clock. Not only is this illegal, but it can result in costly lawsuits and payment of back wages if these employees ever decide to bring litigation for the unpaid overtime.

Many large companies are reducing the number of hours employees work, to help cut costs. Employees were required to work one less day every two weeks. Six months later, financial performance improved. Motorola employees went back to work full-time. The downsizing approach at Motorola promoted teamwork and unity in the organization (Bergmann 522).

Job Sharing

Job sharing is another method companies can consider to reduce costs. Many companies are exploring this new method to help cut costs in the organization. Two employees can share title, workload, salary, and vacation. Overtime is reduced and twice as much talent and creativity is available. It also eliminates the need for training a temporary employee when one employee is sick.

Early Retirement

Early retirement, for selected employees, is a possible alternative to downsizing. The programs involve partial pay and benefits, stretched over several years. Early retirement programs are intended to provide incentives to terminate. It is important to identify which jobs should be eliminated so companies do not lose all their highly skilled, senior level employees. Employees are more likely to retire when they have reached their occupational goals and their home life seems more attractive than their work life.

The effectiveness of early retirement programs hinges on voluntary offers. If pressure is brought to bear on employees to accept early-out packages, the perception of the program is the same as if it were a layoff. All of the organizational benefits gained by providing severance payments are lost when employees feel that they have lost control of their careers.

Voluntary Severance

Voluntary severance packages, which offer employees an amount of money for every unit of time they have been employed by the company are probably the least invasive of all reactive techniques for reducing the payroll. Voluntary severance does carry a hefty price tag, but it is an effective way of reducing wages over the long term. For some employees, this is all the incentive they need to start their own business, go back to school, or strike out in some other direction. The point is control over their own destiny, preserving the trust of the remaining employees and giving those who leave a sense of dignity and self-confidence.

Dealing with Survivors

If downsizing must occur, employers might consider notifying the affected employees. In today's job market, we are only employable as long as our services are needed. Therefore, it is possible to notify the employees that their services are not needed after a certain time period. Most employees will remain productive and we must change our paradigm that says employees cannot be trusted and motivated if they know they are losing their jobs. The new paradigm is that we are all temporary employees and employed as long as our services are needed. We have

more control when we know our destiny and will not be paralyzed by fear and uncertainty.

It is imperative companies develop strategic plans beyond the reduction in force and focus on the organization two years from the reduction in force. This will eliminate the need to make drastic cuts each year. An attitude survey should be administered approximately one year after the reduction in force. The survey provides employees with a method of expressing what is going well and what is not. The survey can also provide suggestions on changing processes that are ineffective (Bergmann 524).

Training

Employees who are expected to take on new job responsibilities should receive the proper training to increase their opportunities for being successful in their new expanded roles. To help employers determine training needs, skills assessments can be used for measuring an individual's strengths and weaknesses in specific job functions. Without proper training, employees will become stressed if they feel they cannot perform their new responsibilities effectively and will feel inadequate with the additional responsibilities.

Training departments need to prepare for the changing needs of the company. The training staff must anticipate the needs of the organization, and provide appropriate training and planning for the new

jobs. Organizations will experience constant change, and most of the current jobs will probably not be here in 20 years.

Career value in the future will depend on how long your current job and skills add effective value to the organization. Cradle-to-grave job security with one employer is over. Companies want flexible people who can adapt to rapid change, and add value to products and services. Those who have multiple skills are the most valuable players in companies undergoing rapid change (Bergmann 527).

Employee Input

The operational procedures of the reduction in force can be discussed with the employees. Re-engineering teams should be formed to find areas that are nonvalue added. Employees have a better understanding of the problem areas in their jobs. They can identify where improvements can be made and how the improvements will affect financial performance. Management will provide the general direction for the teams, but will encourage employees to make recommendations to improve existing processes (Bergmann 524).

Reengineering in the 90s and beyond requires adaptable, multi-skilled employees who are, in short, generalists. Often it requires organizations to operate on a team based approach, led by managers who are viewed as integrators and communicators. Employees need to invest in themselves. They need to make sure their skills are marketable

and current. The new career path may involve periods of downward mobility. Your chronological age is not as important as how your current job and skills add effective value to your organization.

Downsizing does not cure all the problems, especially if the company does not overhaul the way they do business. Organizations need to create strategies and tactics that help them reach a more efficient environment and structure. Sometimes it is necessary to restate the company mission so employees know what is needed to become a new, better, more efficient place of business. Also, the Human Resources Department needs to develop a meaningful compensation philosophy. A team-based work culture might be appropriate in many organizations. The main point in any restructuring environment is to keep communications open and constant, and provide concerned employees with clearly defined short-term goals. Conducting face-to-face meetings and town forums between upper-level executives and all employees to communicate the new corporate vision provides a medium for open dialogue. Appendix A suggests guidelines for implementing reductions in force and may be helpful during the reorganization.

It is imperative companies develop strategic plans beyond the reduction in force. This will eliminate the need to make drastic cuts each year and focus on the organization two years from the reduction in force. An attitude survey should be administered approximately one year after the reduction in force. The survey provides employees with a method of

expressing what is going well and what is not. The survey can also provide suggestions on changing processes that are ineffective (Bergmann 524).

Appendix A

Guidelines for implementing reductions in force

P	Plan rif with Human Resources Department
R	Rally employees around a "new" corporate vision
O	Operate in ways that says "we are all in this together"
A	Actively involve employees in operational decisions
C	Communicate, communicate, communicate
T	Treat terminated employees with respect and dignity
I	Increase support to "surviving" employees
V	View rif as a means, not as an end
E	Ensures executive management is visible throughout rif

Source: Bergmann, Thomas J., Kenneth P. DeMeuse, and Paul A. Vanderheiden. "Announced Layoffs: Their Effect on corporate Financial Performance." Human Resource Management 33 (1994): 525.

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