

## **Layoffs and Outcomes for CEOs and Firms<sup>1</sup>**

Kevin F. Hallock  
Institute for Compensation Studies, ILR School  
Cornell University

Do CEOs profit when workers are laid off? Whether or how CEO pay is linked with employee job loss or downsizing is not really a new question, but it does seem to be of increasing interest. In fact, how a company overall fares following a mass layoff is the focus of an interesting new working paper by Elizabeth Handwerker and Lowell Mason (2013). Handwerker and Mason estimate what happens to employers following mass layoffs using the methodological framework that has heretofore been used to study the long-term impact of layoffs on employees (e.g., Handwerker, Hildreth and von Wachter 2009). Essentially, the authors are asking whether or not firms that execute mass layoffs later experience a rebound or growth in their employment levels.

Handwerker and Mason find that firms' long term, post-layoff employment patterns vary by reason for the layoff as well as by other firm characteristics (e.g., age, business complexity). As expected, employers reporting seasonal slowdown as the reason for a mass layoff do see their employment levels recover quickly, "only to fall again each year." Employers that gave other reasons for the layoff, among them "Organizational Reasons" or "Production Reasons",<sup>2</sup> were experiencing "slowly growing levels of employment before the mass layoff, and particularly sharp declines in employment which continue well after the initial quarter of the mass layoff" (p. 12). In these cases, the company may well have prospered by or survived due to the downsizing decision, but employment growth was not part of the post-layoff experience. Important to note, they also conclude that "[m]ass layoffs in the 2001 recession look very similar to mass layoffs in the 1990s expansion and the 2000s expansion, but mass layoffs in the Great Recession of 2007 – 2009 occurred at employers with more stable employment levels before and after the layoff" (p. 24)

Turning to the post-layoff experience of the person leading the company, twenty year ago a provocative press release appeared titled "CEOs Win Workers Lose" (Institute for Policy Studies, 1994). The piece listed the companies, then, with the largest number of layoffs and also listed the raises for their CEOs. The average raise for the CEOs was over 30% and the report and others who took up its findings seemed to suggest that the layoffs *caused* the raises.

---

<sup>1</sup> A closely related essay will appear in the "Research for the Real World" column in WorldatWork's *Workspan* magazine, June 2013 edition.

<sup>2</sup> Handwerker and Mason report the "Other Reasons" category to include "Organizational Reasons," "Financial Reasons," "Production Reasons," "Disaster/Safety Reasons," or "Other/Miscellaneous Reasons." With the exception of "Disaster/Safety Reasons," all these could be a reason given if the mass layoff resulted from the adoption of productivity-enhancing technologies that resulted in an employee downsizing, but could also capture other explanations as well.

The implied causation was intriguing, but it turned out that when I did my own calculations for those CEOs, although the *mean* raise was 30%, the *median* was less than half that -- about 11% and nearly identical to the median increase for *all* CEOs of the top 800 U.S. publicly traded companies that year, regardless of whether or not their companies experienced layoffs.

Prompted by this press release, I collected data from about a thousand firms over a seven year time span, including data on employee layoffs, CEO characteristics (e.g. age and seniority) and company characteristics (e.g., size, shareholder returns and market value) to explore more robustly the relationship between layoffs and CEO pay (Hallock, 1998). Applying standard statistical analysis, I found further evidence to dampen the emotive reaction evoked by that earlier press release. Separating companies into those that made a layoff announcement in the previous year and those that didn't, it was the case that the CEOs who made at least one large layoff the previous year did make a lot more (about 40% in cash pay) than those that made no layoffs in the previous year. But, controlling for company and CEO attributes, the findings change quickly.

CEOs of bigger firms earn more than CEOs of smaller firms. It also turns out that, among publicly traded companies, bigger firms are more likely to have layoffs. So controlling for just the market value of the firm (or the number of employees, or assets – it doesn't really matter), those CEOs leading firms that announced a layoff the previous year only make about 12% more than those that did not. And, after controlling for lots of other things (e.g., CEO age and experience, firm industry, stock returns and the like), there was absolutely no relationship between layoffs and CEO (cash) pay or pay raises. Then, like now, a lot of the public discourse about CEO pay seems to involve throwing out provocative statistics which can too easily be dismissed, missing a deeper conversation about truer casual factors.

But, that first study of mine only examined current pay (salary, bonus and other). Isn't a lot of CEO pay wrapped up in stock and stock options held by executives; what about that? For publicly traded companies in the U.S., CEOs are not only frequently granted stock and stock options, but they also can hold considerable equity in their firms. It is important to consider, therefore, whether and how the stock market reacts to announcements of layoffs, if we are interested in the relationship between layoffs and CEO compensation. Even if there is no relationship between CEO *current* pay and layoffs, if the stock market reacts positively or negatively to layoff announcements, there still could be substantial material effects on CEO wealth.

I investigated this in a number of papers, including a more recent one with Henry Farber (Farber and Hallock 2009; Hallock 2009), and found was a notable shift between the 1970s and 2000s in the reaction of the stock market to layoff announcements. Specifically, the stock price reaction to layoffs was negative in the 1970s and became increasingly less so (on average) over 40 years when it ended most recently, weakly positive in the 2000s. Farber and I reasoned that in the 1970s layoff announcements would be met with immediate stock price declines (example: deficient demand in the US

automobile market at the time) and in the 2000s layoffs might be met with stock price increases (example: “efficiency” and “belt-tightening”). In fact, we found evidence of just that. Specifically, the stock price reaction to layoffs was negative in the 1970s and became increasingly less so (on average) over 40 years when it ended most recently, weakly positive in the 2000s.

Some ask: but don’t CEOs get fired if their firms get into so much trouble that they must resort to layoffs? Sometimes. In an additional paper with Sherrilyn Billger (Billger and Hallock, 2005), we investigated the link between CEO turnover, mass layoffs and stock prices. Among our findings are that mass layoffs in firms are significantly related to CEO turnover (voluntary or involuntary departure) the following year and, in some time periods, layoffs are strongly related to CEO turnover two years later. We also find that if the stock market reacts positively to a layoff announcement, the CEO is likely to stay on for some time. However, if the stock market responds negatively to the layoff announcement, the CEO is, before too long, also much more likely to exit the company.

In the context of today’s public frustration with CEO pay and the continuing labor market doldrums, to better understand whether or not employment growth returns, it is important to understand why layoffs happen. Additionally, the link between job loss in firms and CEO pay is also interesting. Since 2000, things are perhaps changing and new studies are needed to better understand what’s different.

## References

- Billger, Sherrilyn M. and Kevin F. Hallock. 2005. “Mass Layoffs and CEO Turnover,” *Industrial Relations*, (July 2005).
- Farber, Henry S. and Kevin F. Hallock. 2009. “The Changing Relationship Between Job Loss Announcements and Stock Prices: 1970 – 1999,” *Labour Economics*.
- Handwerker, Elizabeth Weber and Lowell Mason. (2013). “What Happens to the Employers Involved in Mass Layoffs?” mimeo, Bureau Labor Statistics.
- Handwerker, Elizabeth, Andrew Hildreth and Till von Wachter. 2009. Estimating the True Cost of Job Loss: Evidence Using Matched Data from California, 1991-2000, CES working paper 09-14, Bureau of Labor Statistics.
- Hallock, Kevin F. 2009. “Job Loss and The Fraying of the Implicit Employment Contract,” *Journal of Economic Perspectives*, (Fall, 2009).
- Hallock, Kevin F. 1998. “CEO Pay, Layoffs and Firm Performance,” *American Economic Review* (September, 1998).