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Linking Compensation and Job Losses During a Recession

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research for the real world

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In recessionary times, what is the link between compensation and job losses? Are job losses really inevitable?

The indisputable relationship between compensation and job loss may be more malleable than generally assumed. Do organizations really consider all possible combinations of work hours and total rewards when business slack necessitates cutbacks?

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Lifetime Employment in Cleveland?

For more than 60 years, Lincoln Electric has maintained a policy of guaranteed continuous employment — no permanent U.S. employee has been laid off for lack of work. For Lincoln Electric, employee layoffs aren't a last resort, the option isn't even up for discussion. Instead, merit-based bonus pay, mandatory hours-reductions and nimble project assignments are all among the tools that Lincoln Electric's leadership draws on when it needs to respond to business cycles turning south. (The most complete discussion of Lincoln Electric's unique management is found in Frank Koller's 2010 book "Spark: How Old-Fashioned Values Drive a Twenty-First-Century Corporation: Lessons from Lincoln Electric's Unique Guaranteed Employment Program," PublicAffairs, a member of Perseus Books Group.)

How has this company fared through the Great Recession? I'd say pretty well. 2010 marked the 10th consecutive year that Lincoln Electric increased its dividend, and stock price gains have fairly consistently outperformed the S&P 500 during the past five years.

As the company explains in its annual report, "During the recession, we shifted talented employees with appropriate skills and experience into specific R&D [research and development] and market development projects with strong future growth potential. As a result, we were able to hit the ground running in 2010 with a strong portfolio of new products to better meet our customers' needs as the markets started to rebound. Overall, we introduced 108 new products in 2009 and many more in 2010."

Why Don't Organizations Use Work Sharing Unemployment Insurance?

For most organizations, when costs need to be cut, shedding some workers is part of the solution. In addition to the immediate loss of income for laid-off or downsized employees, further problems arise for those let go (including the potential for lower compensation in their next job and even health consequences) and for remaining employees (sometimes referred to as survivor syndrome). Work Sharing Unemployment Insurance (WSUI) tries to mitigate these negative repercussions by encouraging an alternative approach to outright downsizing of employee headcount (see Thomas MaCurdy, James Pearce and Richard Kihlthau, "An Alternative to Layoffs: Work Sharing Unemployment Insurance," California Policy Review, August 2004). Suppose that a firm wanted to cut 20 percent of its labor costs and that all workers were paid the same. One option is to lay off 20 percent of the workers. Another option, allowed in 17 states, is to participate in WSUI and reduce hours of all workers by 20 percent. (Of course, firms could do some combination in between.)

Under WSUI, workers are eligible for a prorated fraction of unemployment insurance benefits. From an employer's standpoint, the first-order economic costs of WSUI and regular unemployment insurance are identical since the identical taxes are paid by the company. However, proponents of WSUI argue that hiring, firing and retraining costs are high and that firms can save in the long run when demand returns if they keep workers, even at reduced hours.

MaCurdy, Pearce and Kihlthau noted that fewer than 1 percent of California companies with unemployment insurance claims use WSUI; the vast majority use unemployment insurance. Among the reasons for this are that firms may prefer to have fully engaged and employed workers rather than underemployed ones, and if workers are told their hours may be cut, they may search for jobs elsewhere. Similar systems are in place in many other countries including Belgium, Denmark, France, Germany and Sweden. In any event, why so few firms choose to use WSUI is a question for more research. Questions can include why this works elsewhere and not in the United States, why some states allow it and others don't, and what the longer-term consequences are of WSUI.

Is There a Link Between CEO Pay and Job Loss?

Some have argued that there are times when workers are fired while CEOs and other executives enjoy large pay raises and increases in wealth. Research I conducted on more than 800 companies for a period of seven years (Kevin F. Hallock, "Layoffs, Top Executive Pay and Firm Performance," The American Economic Review, 88(4), September 1998, 711-723) showed that if firms are split into two groups — one that made layoffs in the previous year and one that did not — the group that conducted layoffs paid their CEOs more and gave their CEOs larger raises when nothing else is controlled for. However, when the size of the organization is controlled, as well as many other characteristics of the CEO and company, there is no relationship between worker job loss and CEO pay. Furthermore, since CEOs hold wealth in their firms, it is interesting to examine the stock price reaction to job loss announcements, because if the stock price goes up, on average, at the time of the job loss announcements, the CEOs could profit that way. The evidence suggests that they did not profit in this way.

In a related paper I wrote with Sherrilyn Billger (Sherrilyn M. Billger and Kevin F. Hallock, "Mass Layoffs and CEO Turnover," Industrial Relations, 44(3), 2005, 463-489) about the relationship between CEO turnover and job loss, our research showed that noting the stock price reaction following a firm's job loss announcement indicates how long the CEO will last. If the market reacted positively right after the layoff announcement, the CEO is likely to stay. Yet, if stock prices go down at the time of the announcement, chances are much higher that the CEO will leave within a few years.

A large fraction of costs in most organizations is labor and related expenses. Compensation and benefits across all workers add up quickly, and the higher the pay or the larger the headcount, the more quickly it mounts. As the global labor market continues its recovery from the Great Recession, research will again expand our knowledge of employer practices and possibilities for softening job losses while maintaining a competitive edge. We look forward to research insights informing constant improvement and innovative practices for maximizing the value of talent for shareholder gains while considering the surrounding social context. ws

got a question

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