BroadBranch Advisors

The Case Against Layoffs

If one thing is certain in today's economic environment, it's uncertainty. On the heels of a pandemic that triggered a wave of unprecedented fiscal and monetary policies that precipitated a boom in 2021, stakeholders and decision-makers in government and business alike spent much of 2022 preparing for a bust. Aggressive measures by governments combined with global supply chain crises drove inflation to levels not seen since the 1980s, triggering a rising interest rate environment largely foreign to current inhabitants of both Wall Street and Main Street. These factors have left CEOs and Board Directors wondering whether the great post-recession bull run has finally come to an end and how to deal with the associated decline in demand.

Although reductions may prove beneficial in the short term, might companies that can resist cutting headcount be better positioned for long term financial success?

Though many organizations have taken admirable measures to avoid headcount reductions in the past twelve months, layoffs are widely viewed as an undesirable albeit inevitable next step. Beginning in the tech sector, with highly publicized terminations at Google, Microsoft, and Amazon, layoffs are steadily creeping into other industries. Goldman Sachs, FedEx, 3M, and Rivian have recently announced layoffs in the wake of disappointing earnings and increased recessionary fears.

"[Recent layoffs] are critical to ensure we remain competitive in a rapidly changing environment," FedEx CEO Raj Subramaniam recently wrote in a letter to staff. But what if they aren't? Although reductions may prove beneficial in the short term, might companies that can

resist cutting headcount be better positioned for long term financial success?

Motivation for layoffs

At face value, layoffs may appear a panacea for a number of unpleasant situations that CEOs face. The threat of a looming recession, stubbornly high inflation, record low unemployment rates, and a tightening Federal Reserve have caused many to doubt the likelihood of a so-called “soft landing” where inflation targets are met without pushing the US economy into a recession. In addition to these macroeconomic factors, there may also be other reasons that cause executives and boards to look for redundancies.

The booming economy of 2021 and associated white-hot job market led many organizations to grow very quickly to keep pace with rapid increases in demand. As Wayfair

CEO Niraj Shah recently noted, “we overcomplicated things, lost sight of some of our fundamentals and simply grew too big.” Leaders may see reductions as a natural way to right-size or pivot organizations that overestimated market demand for their products.

Another motivation for trimming jobs is the desire to satisfy the investment community. Trimming jobs may be seen by investors as a move needed to cut costs to drive profitability in times of waning demand, although findings indicate otherwise.

Lastly, management teams may even view uncertain economic waters as an opportunity to pivot their organizations by reducing headcount in parts of the company that are struggling or are at odds with the organization’s current direction – leveraging a tenuous situation to bring what they believe is much needed organizational change.

Short-term drawbacks

While layoffs may seem like a simple way to cut costs and trim operations, many executives have become far too cavalier about this decision, regarding it as a go-to solution for turbulent times rather than a last-ditch effort to address specific staffing needs. Executives should think carefully before downsizing, as an abundance of both

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academic research and real-world business outcomes suggest that much of the reasoning behind these layoffs is quantifiably false.

Common immediate repercussions of layoffs include the risk of a severe PR backlash, jeopardizing a company's ability to attract badly needed revenue. Nokia's 2008

layoffs sparked protests, boycotts, and demands to repay government subsidies, ultimately costing the company over $110,000 per laid-off employee, according to The Harvard Business Review. These direct effects are often exacerbated by an executive's failure to appropriately message layoffs, inadvertently making it obvious that they failed to treat the decision with the gravity that such a decision ought to hold.

Recent examples of poorly communicated layoffs include Better.com CEO Vishal Garg, who fired 900 employees on a 3-minute Zoom call just before the holidays, and PagerDuty CEO Jennifer Tejada, whose layoff announcement misused Dr. Martin Luther King's words, "the ultimate measure of a [leader] is not where [they] stand in the moments of comfort and convenience, but where [they] stand in times of challenge and controversy." This message was widely panned as tone-deaf for its inclusion in an email announcing layoffs while simultaneously celebrating a senior executive's promotion. Leaders should carefully consider how they think and speak about scenarios where team members' lives are upended while executives' are largely spared.

Layoffs have a direct, prominent impact on those let go, but they also exact a toll on remaining employees, undercutting trust in leadership and harming productivity. In the paper "No security: a meta-analysis and review of job insecurity and its consequences," researchers found that survivors of layoffs see job satisfaction decrease by 41%, organizational commitment decrease by 36%, and job performance decrease by 20%. This can already be observed in the wake of Google's largest layoff ever, where an engineer told Business Insider that

remaining employees have broken down in tears in the middle of meetings and organized a protest against the company's decision, according to Shacknews. Moreover, amid a tight labor market, terminating capable employees essentially offers their skills and know-how to competitors at a discount and encourages remaining, highly qualified personnel to seek opportunities elsewhere.

> **"If people are your most important assets, why would you get rid of them?"**
>
> – Former Head of Human Resources at Southwest Airlines

How and why to avoid layoffs

Although avoiding layoffs may prove challenging, it is usually achievable and beneficial. While competitors rush to terminate thousands of employees, Nvidia, Broadcom, Fidelity, and others have all demonstrated continued success without layoffs. Of course, it is easy to see why this route lacks immediate appeal in many boardrooms: some, like Apple, have recently slashed executive compensation packages, and others, like Palo Alto Networks CEO Nikesh Arora elected to forego a salary entirely to avoid layoffs during the pandemic – his company has since dramatically outperformed the S&P 500.

Other alternatives to layoffs include retraining and upskilling employees. AT&T, for example, chose to retrain employees from slower-growth job functions into higher-growth ones. By promoting a culture of continuous learning and development, AT&T not only prevented the loss of talent and trust but also cut its product-development cycle time by 40% while accelerating time to revenue by 32%.

Although executives issuing layoffs prefer to downplay their own agency in the matter by characterizing it as an "unavoidable" or "necessary" measure for improving profitability, the benefits of layoffs are, in fact, short-lived and negligible compared to their protracted, adverse consequences. Controlling for prior performance, downsizing has been empirically shown to decrease companies' subsequent profitability. In the paper "Dumb and Dumber: The Impact of Downsizing on Firm Performance as Moderated by Industry Conditions," Wharton Professor Peter Cappelli, an expert in management and human resources, notes that he "has not found any support for the overall idea that layoffs help firm performance... There is no evidence that cutting to improve profitability helps beyond the immediate, short-term accounting bump." Factor in the costs of severance pay, hiring, and onboarding, and that short-term 'benefit' starts to look substantially less compelling.

According to data from the National Bureau of Economic Research, since 1948, the average recession in the United States has lasted about 10 months. Viewed differently, various financial media outlets calculate the average U.S. bear market to last between 289 and 389 days. Either way, markets rebound quickly, rallies outlast troughs, and those who benefit most from the meteoric rebounds are those

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who remain fully invested at the bottom – not those who panic and react to short-term stressors, but those who plan proactively and position themselves to dominate during the inevitable recovery.

Retaining institutional knowledge and productive capacity is instrumental in swiftly satisfying post-recession demand and cultivating the innovation necessary to preserve and grow market share. Layoffs delay R&D initiatives, undermining business continuity and strategic growth opportunities. Faced with a reduced headcount, teams quickly become overburdened as they scramble to compensate for lost manpower by shouldering more responsibilities, which begets frustration, exhaustion, and burnout. Layoffs stifle innovation and erode a company's competitive edge, all while providing few – if any – discernible long-term benefits.

Layoffs have become all too common at companies where they are neither necessary nor likely to provide significant long-term benefits. While layoffs remain a popular course of action for executives amid periods of heightened economic uncertainty, many common assumptions underlying the arguments supporting layoffs do not hold up under even minimal scrutiny. In fact, layoffs constitute a cosmetic, lazy solution to near-term problems with many severe impacts on company performance and culture, which tend to far outweigh their meager benefits in the long run. Instead of serving as executives' go-to cost-cutting measure, layoffs should be exercised only as a measure of last resort. Many firms now laying off employees will soon find that they have only impaired their own ability to compete once the economy eventually settles back into a period of sustained growth, whereas those taking more measured, creative approaches to weathering the storm will find themselves in a superior position to seize on that growth and dominate their fields.

BroadBranch Advisors has deep experience helping customers be leaders in market innovations such as clinical decision support through go-to-market strategies, competitive benchmarking, and voice-of-customer analysis. If you are interested in better understanding changing market dynamics or seek strategic guidance to help you make better decisions, please reach out to Courtney Matson (courtney@brbradv.com) or Greg Thompson (greg@brbradv.com) to learn more about how we can collaborate. You can also read other market perspectives written by our team here.

BROADBRANCH
ADVISORS

Jordan Cynewski
Associate
jordan@brbradv.com

Nate Stratton
Director
nate@brbradv.com

Greg Thompson
Partner
greg@brbradv.com