BroadBranch Advisors

The Case Against Layoffs

BroadBranch previously published a version of this article in layoffs of early 2023. In light of the recent resurgence of layoffs article has been updated in the following ways:

- ◊ All data, examples, and references have been updated to reflect the new 2024 timeframe.
- ◊ The updated introduction provides context for this year's new wave of layoffs with discussion of the economic conditions leading up to the present, including the 2021 boom, 2022/2023 recession fears, interest rate hikes, etc.
- ◊ The companies used as examples of recent layoffs have been updated, with 2023 examples like Goldman Sachs, FedEx, and Rivian replaced by 2024 examples like Twitch, Schwab, and Time Magazine.
- ◊ There are new examples of poorly communicated layoffs, including Discord and Cloudflare.
- ◊ Research studies and expert opinions cited are mostly the same, but some statistics have been updated with more recent data.
- ◊ Alternatives to layoffs now mention specific workforce redeployment platforms like Worqdrive.

Paralyzed by uncertainty, most companies have operated conservatively in the post-COVID era. Across sectors, executives have largely remained hesitant to make significant investments, instead tightening purse strings, trimming workforces, and waiting with bated breath for a much-talked-about recession that never came.

After the pandemic triggered a wave of unprecedented fiscal and monetary policies which precipitated a boom in 2021, stakeholders and decision-makers in government and business alike spent much of 2022 and 2023 preparing for a bust. Aggressive relief measures by governments, in conjunction with global supply chain crises, drove inflation to levels not seen since the 1980s, leading central banks to create a high interest rate environment largely foreign to the current inhabitants of both Wall Street and Main Street. These factors have left CEOs and boards of directors wondering whether there has been a lasting paradigm shift around economic growth and how to deal with the associated decline in demand.

Though many organizations have taken admirable measures to avoid headcount reductions in the past two years, layoffs are still widely viewed as an undesirable albeit inevitable next step. Beginning in the tech sector with highly publicized terminations at Google, Microsoft, and Amazon, layoffs steadily crept into other industries in 2023. Goldman Sachs, FedEx, 3M, Rivian, and over 1,000 others announced layoffs last year amid disappointing earnings reports and increased recessionary fears.

In 2024, talk of a recession has mostly subsided, a tentatively optimistic consensus has emerged around a soft landing, and the stock market has rebounded to an all-time high. However, policymakers and analysts alike have remained reluctant to declare victory. The Federal Reserve has yet to commit to the 2024 rate cuts it has previously hinted toward, major financial publications continue to emphasize potential stumbling blocks along the way, and business leaders have followed suit. Even if a recession is not imminent, many large companies have still tempered their growth expectations, setting off a new wave of layoffs to kick off 2024.

Chief executives at Twitch, Schwab, and Time Magazine have all described their recent layoffs as “necessary,” echoing the terminology used last year to describe layoffs

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at FedEx, Alphabet (Google), and others. But what if the opposite is true? What if these mass terminations are not only unnecessary, but an impediment to future growth? Although reductions may prove beneficial in the short term, might companies that resist cutting headcount be better positioned for long-term financial success?

Motivation for layoffs

At face value, layoffs may appear a panacea for many undesirable situations that CEOs face. The threat of a recession, stubborn inflation, record low unemployment rates, and high interest rates continue to stoke concerns that there will be no soft landing after all. In addition to these macroeconomic factors, there may also be other reasons that cause executives and boards to look for redundancies.

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

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. Rationalizing the decision to lay off 17% of his company’s employees this year, Discord CEO Jason Citron wrote, “We grew quickly and expanded our workforce even faster, increasing by 5x since 2020. As a result, we took on more projects and became less efficient in how we operated.” 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. This 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.

Drawbacks of layoffs

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

For one thing, 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.

Other 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 it ought to hold.

Since the pandemic, several CEOs have made headlines for poorly communicating layoffs to their employees: Better.com CEO Vishal Garg fired 900 employees on a 3-minute Zoom call just before the holidays, and PagerDuty CEO Jennifer Tejada was widely panned for misusing a quote from Dr. Martin Luther King, Jr. to congratulate herself on her leadership abilities in an email simultaneously announcing layoffs and celebrating a senior executive's promotion. More recently, former Cloudflare employee Brittany Pietsch went viral after uploading a video of her firing to TikTok. For its part, Cloudflare maintains that Pietsch's termination was not part of a layoff, but the poorly executed nature of her firing – by two HR employees who had previously never met Pietsch and failed to answer any of her questions – sparked public outrage toward Cloudflare and forced its CEO to publicly admit that the company had made a mistake and lacked humanity. 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. The New York Times similarly reported that Meta's 2023 layoffs triggered a "morale crisis," with a former global HR director describing an ineffective, chaotic workplace dominated by desperation and fear: "it's 'Hunger Games' meets 'Lord of the Flies,' where everyone is trying to prove their worth to management."

This effect is not isolated to big tech. In fact, it is a well-documented phenomenon, which Stanford University Professor of Organizational Behavior Jeffrey Pfeffer has termed "layoff contagion." Pfeffer's research has also found that laid off workers have a 63% higher risk of death, contributing to more than 120,000 deaths per year in the U.S.

Avoiding layoffs

Although avoiding layoffs may prove challenging, it is usually achievable and beneficial. While competitors rush to terminate thousands of employees, Nvidia, Crowdstrike, Mastercard, and others have all demonstrated continued success without layoffs. Some, like Snowflake, even announced plans to hire 1,000-plus employees while industry rivals were cutting jobs, affording them a unique opportunity to poach high-quality talent at a bargain. Of course, it is easy to see why this route lacks immediate appeal in many boardrooms: some executives took steep pay cuts, while 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 both the S&P 500 and the tech sector as a whole.

Other alternatives to layoffs include retraining and upskilling employees. In fact, several companies now offer designated platforms that are specifically designed to avoid layoffs through workforce redeployment and talent mobility. According to one such platform, Worqdrive, "the average layoff in Q3 2023 was about 280 people. These same companies, on average, had almost 200 open jobs." By retraining employees from slower-growth job functions into higher-growth ones and promoting a culture of continuous learning and development, employers can prevent the loss of both talent and trust.

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 was 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." Similarly, Wharton Professor Peter Cappelli, an expert in management and human resources, "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.

Short-termism is the antithesis of strategy, leading near-sighted companies to sacrifice their long-term growth objectives in order to maintain the temporary and hollow façade of success.

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– Wharton Professor Peter Cappelli

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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 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 and undermine 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

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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 gains. 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 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.

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BROADBRANCH
ADVISORS

Jordan Cynewski
Associate
jordan@brbradv.com

Greg Thompson
Partner
greg@brbradv.com