

CEO Pay and Layoffs

Do CEOs profit when workers get fired?

Whether CEO pay is linked with job loss or mass layoffs is not really a new question. In fact, I first started thinking about this nearly 20 years ago when I was in graduate school. I saw a provocative press release headlined “CEOs Win, Workers Lose” (Institute for

Policy Studies, 1994). The piece listed the companies with the largest number of layoffs at that time and also listed the raises for their CEOs. The average raise for the CEOs was more than 30 percent; the report and others who took up its findings seemed to suggest that the layoffs caused the raises.

The implied causation intrigued me, so I figured I'd look a little deeper into the connection between CEO pay and mass layoffs. The first thing I did was calculate the median raise of those several dozen CEOs. This revealed that although the mean raise was 30 percent, the median was nearly identical to the 11 percent median increase for all CEOs of the top 800 U.S. publicly traded companies that year, regardless of whether their companies experienced layoffs.

The Simple, Baseline Link

My next step was to collect more data — a lot more data. The study that got me started, and raised very interesting issues about job loss and compensation, looked at CEOs at a few dozen companies over one year. I collected data from about 1,000 firms over seven years. Finding the CEO pay data for publicly traded companies was easy; collecting detailed information on employee layoffs was not (and required combing through many thousands of indexed newspaper accounts).

I added to the salary and layoff data a bunch of information on CEO characteristics (e.g., age and seniority) and



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company characteristics (e.g., size, shareholder returns and market value). I then used some standard statistical techniques to probe the relationship between layoff announcements and CEO pay more carefully. The original results are reported in Kevin F. Hallock, “CEO Pay, Layoffs and Firm Performance,” *American Economic Review*, September 1998).

Separating companies into those that made a layoff announcement in the previous year and those that didn't, you will find that the CEOs who made at least one large layoff the previous year make a lot more (about 40 percent in cash pay) than those who made no layoffs in the previous year. But, once one starts controlling for company and CEO attributes, essentially subdividing companies and their CEOs by other characteristics (like company size and CEO seniority), the findings change quickly. For example, we all know that bigger firms pay CEOs more (Kevin F. Hallock, “The Relationship Between Company Size and CEO Pay,” *workspan*, February 2011). It also turns out that, among publicly traded companies, bigger firms are more likely to have layoffs. So once we control 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 percent more than those who 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.

But, isn't a lot of CEO pay wrapped up in stock and stock options? What about that?

But What About All of the Stock and Options?

We all know that for any publicly traded companies in the United States, CEOs are not only frequently granted stock and stock options, but they can also hold considerable equity in their firms. So the natural next step would be to consider whether the stock market reacts to announcements of layoffs. 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 the one mentioned previously, a more recent one with Henry Farber (Henry S. Farber

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and Kevin F. Hallock, “The Changing Relationship Between Job Loss Announcements and Stock Prices: 1970–1999,” *Labour Economics*, 2009, and in Kevin F. Hallock, “Job Loss and the Fraying of the Implicit Employment Contract,” *Journal of Economic Perspectives*, Fall 2009).

What we 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. We reasoned that in the 1970s layoff announcements would be met with immediate stock price

declines (example: deficient demand in the U.S. 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.

What About CEO Firings?

Some ask: But don't the CEOs get fired, too? Sometimes. In an additional paper with Sherrilyn Billger (Sherrilyn M. Billger and Kevin F. Hallock, “Mass Layoffs and CEO Turnover,” *Industrial Relations*, July 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 the following year and, in some time periods, layoffs are strongly related to CEO turnover two years later. We also found 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.

As the U.S. labor market continues its slow climb out of the doldrums, how CEOs, other employees and firms fare after employee layoffs will continue to be an interesting topic, and there is a lot more interesting research to be done. **WS**



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question

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