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The Impact of Layoff Announcements on Shareholders

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Aller au sommaire du numéro

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Résumé de l'article

Il est de croyance populaire que les lienciements sont bénéfiques pour les investisseurs et que ce sont les employés qui subissent le fardeau des réductions corporatives. En fait, il y a peu de recherche sur le sujet, et celle qui existe vise surtout des firmes américaines. De plus, la recherche existante peut être biaisée par le fait qu'elle fait des moyennes de réactions aux réductions en temps de récession et en temps de prospérité. On sait très bien que les réactions peuvent varier entre ces deux périodes.

Conformément à la recommandation de l'Academy of Management d'étudier le comportement des actionnaires tant à l'intérieur qu'à l'extérieur de l'organisation, la présente étude examine l'effet des licenciements sur les actionnaires. L'échantillon utilisé inclut 137 licenciements par 57 entreprises canadiennes pendant la période de récession allant de janvier 1989 à août 1992. Nous avons utilisé la technique étude-événement, grandement utilisée en finances, pour vérifier si le prix des actions des entreprises qui annonçaient des licenciements variaient positivement ou négativement.

Les résultats indiquent que le prix des actions des entreprises qui annonçaient des licenciements décroissait autour de la date de l'annonce de ces licenciements, cette performance négative n'étant statistiquement valable que lorsque les annonces des licenciements initiaux de chaque firme sont examinées. Cette conclusion concourt avec la théorie du signalement qui veut que la bourse réagisse seulement aux annonces initiales. Les licenciements plus importants amènent des réactions négatives plus significatives sur le prix des actions (conformément aux conclusions de l'étude de Worrell et al. 1991). La performance financière antérieure des entreprises n'est pas un facteur significatif influençant l'effet des licenciements sur la performance du prix des actions.

Cette conclusion infirme la croyance populaire que les actionnaires profitent des réductions corporatives impliquant des licenciements. Ajoutant ici les conclusions d'autres études à l'effet que les employés sont affectés négativement par les licenciements, la preuve indique que les gestionnaires doivent trouver des voies alternatives pour demeurer compétitifs vu que les licenciements ne bénéficient ni aux employés ni aux actionnaires.

The Impact of Layoff Announcements on Shareholders

NANCY URSEL
MARJORIE ARMSTRONG-STASSEN

This study explores the reactions of shareholders to layoff announcements. We examine shareholders' reactions to 137 layoff announcements by 57 Canadian firms over the period January 1989 to August 1992. Shareholders are found to react negatively to announcements of a layoff in their company. Shareholders have a greater negative reaction to a company's first layoff than to subsequent layoff announcements. Moreover, shareholders respond more negatively to large-scale layoffs than to those involving small percentages of the workforce. The implications of these findings for human resource management are discussed.

Researchers in the human resource management field were recently encouraged to expand their scope of investigation beyond the traditional areas of human resource management (Academy of Management 1992). In particular, it was recommended that researchers focus on the "boundaryless" organization with its various constituent groups both inside and outside the actual organization. An important constituent group that has received little attention in the human resource management research literature is the organization's shareholders. Many business decisions which directly affect the organization's human resources are influenced by investors' interests. In turn, shareholders may be affected by the consequences of managerial decision making. For example, management decisions in the bargaining process may precipitate strike activity. In an investigation of the impact of strikes on shareholders, Becker and Olson (1986) found that strikes

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resulted in a 4% drop in shareholder equity representing a decline of $72–87 million U.S. These researchers conclude that strikes are costly to shareholders.

Faced with the competition from an emerging global economy and the recent recession, many companies in Canada are struggling to survive. In an attempt to become more competitive and to appease shareholders' expectations of reasonable levels of return on their investment, many firms, including those with relatively stable employment histories, have recently engaged in organizational downsizing. Organizational downsizing typically involves some form of workforce reduction, and the most common human resource management strategy for workforce reduction is the use of layoffs (Greenhalgh, Lawrence and Sutton 1988). According to Hardy (1990:1), organizational downsizing "has been, and will continue to be, one of the major challenges facing contemporary managers". Layoffs have been found to have a largely negative impact on both the job losers (Fryer and Payne 1986; Kessler, House, and Turner 1987; Leana and Feldman 1992) and the layoff survivors (Armstrong-Stassen 1990; Brockner and Wiesenfeld 1993; Davy, Kinicki, and Scheck 1991). Although it is generally believed that layoffs are undertaken to benefit investors and that employees bear the brunt of corporate downsizing, there is relatively little empirical research concerning the effect of layoffs on the company's stockholders. Moreover, recent anecdotal evidence suggests that, contrary to common belief, corporate downsizing involving layoffs may not benefit the shareholders (Olive 1993). Thus, the purpose of the present study is to examine how a layoff announcement affects the company's shareholders.

In one of the few studies to examine the impact of layoff announcements on stockholders, Worrell, Davidson, and Sharma (1991) studied layoff announcements made by U.S. firms over the period 1979–1987. These researchers found that investors reacted negatively to layoff announcement. They claimed that layoffs attributed to financial distress elicited stronger negative responses than those due to restructuring or consolidation, and that large layoffs caused stronger negative responses than small layoffs.

Several aspects of the Worrell et al. study warrant further investigation. First, it is possible that the reactions to layoffs differ during recessionary and non-recessionary times. Layoffs during recessions may be viewed positively, as a sign that companies are attempting to reduce costs, whereas layoffs in non-recessions may indicate that the firm is in serious difficulty. Thus, a study such as Worrell et al.'s which averages the reaction to layoffs over recessionary and non-recessionary periods may obscure the true effects.

Second, one must question the distinction between layoffs due to financial distress and those due to restructuring and consolidation, a distinction Worrell et al. make on the basis of reading newspaper articles. One thing that is clear from the recent recession is that the words "restructuring and consolidation" are often euphemisms for financial distress. Moreover, Worrell et al. do not indicate if each layoff announcement in their sample is made by a different company or if some companies have multiple announcements. Reactions to multiple announcements may differ from reactions to single announcements.

Finally, although Worrell et al. searched for newspaper articles containing "hints" or "leakages" about upcoming layoff announcements, they make no mention of checking for other corporate announcements made close to the layoff announcement. The effect of other announcements may bias the estimate of the layoff impact. Further study is needed to clarify these issues.

The present study has two objectives: to estimate the impact of layoff announcements on stock prices, and to model the impact of layoff announcements on stock prices as a function of variables such as size of the layoff. We examine Canadian companies during the recessionary period January 1989 to August 1992. We distinguish between a company's initial and subsequent layoffs and we control for other announcements which may bias the estimate of the layoff announcement effects.

MODELS AND METHODOLOGY

Measuring the Impact of Layoff Announcements on Stock Prices

Stock price reactions to layoff announcements are calculated using an event study technique commonly employed in financial research. Reactions to announcements are calculated as deviations from the returns that would be expected given no announcement, which is assumed to be a linear function of market returns (the "market model"). The formula for the market model is

$$E(R_{jt}) = a_j + b_j R_{mt} + e_{jt} \qquad (1)$$

where $E(R_{jt})$ = the expected return (percentage change in price)[1] for stock j over period t;

1. Sharpe and Cooper (1972) showed that there is a 99% correlation between stock returns calculated including and excluding dividends. We chose to use returns excluding dividends, a common practice in event studies. The return on the TSE 300 [which is the most frequently used index in Canada and the TSE index which includes the most stocks (Hatch 1983)] also excludes dividends.

R_{mt} = the return on the stock market proxy (the Toronto Stock Exchange 300) over period t;

a_j and b_j are parameters to be estimated; and

e_{jt} is an error term which is assumed to have the standard properties.

Thus, reactions to announcements (abnormal price changes or returns) are calculated as:

$$AR_{jt} = R_{jt} - \hat{a}j - \hat{b}_j R_{mt} \tag{2}$$

where $\hat{a}j$ and $\hat{b}j$ are ordinary least squares estimates. The ARj's may be averaged across the shares of different firms experiencing similar events to obtain an average abnormal return for the group, AAR.

Three months of daily stock market data were used to estimate the parameters of equation (1) for each firm. The estimation period ended one month prior to the month of the announcement, in order to insulate the estimation from possible abnormal effects around the announcement date. AR's were then calculated using equation (2) for the day of the announcement and the day following the announcement. Extensive previous research (see summary in Fama 1991) demonstrates that stock markets react efficiently to public announcements. That is, prices react quickly (within one or two days) and prices accurately reflect investors' long-term expectations for the stock. Thus, it is sufficient to examine stock price reactions for only a short two-day period around the layoff announcement. A host of other factors can affect stock prices over time, making it impossible to determine whether layoffs or other factors affected stock prices when a longer time series of stock returns is examined (e.g., the 90-day period examined in Worrell et al.).

The Canadian Business Index was checked to confirm that no other announcements about the company were made over the two-day period around the announcement. This was done to ensure that the measured effect is due to the layoff announcement and not to some other effect. *T*-tests are used to test whether the AAR's are significantly different from zero. Given the additional assumptions of normally, independently, and identically distributed errors, the *t*-value is given by:

$$t = \frac{AAR_t}{\sigma(AAR)/\sqrt{N}} \tag{3}$$

where σ (AAR) is calculated using the three-month preannouncement series of prices and N is the number of days examined (in this case 2). Wilcoxon signed-rank statistics (nonparametric tests of significance) were also calculated, in case residuals were not distributed normally.

Modelling the Impact of Layoff Announcements as a Function of Predictor and Control Variables

Malatesta and Thompson (1985) demonstrate that the magnitude of the impact of announcements on stock prices is a function of two factors: the economic impact of the announced event and the degree to which the announcement has been anticipated by investors. We discuss each of these factors in turn.

The relevance of the economic impact of the announcement on the stock price is quite evident. For example, the announcement of a major corporate event would be expected to have a larger impact on stock prices than would the announcement of a relatively insignificant corporate event.

The degree to which the announcement has been anticipated also affects the stock price reaction. As pointed out by Malatesta and Thompson (1985), events which have been perfectly anticipated by investors prior to announcement by the company will cause no change in the stock price at the time of the announcement – the change will have taken place earlier. However, if investors have not anticipated the event, stock prices may change around the announcement. Therefore, it is important to control for anticipation in order to get a true picture of the economic impact of an announcement. These two factors, economic impact and investor anticipation, influence the variables selected to model the magnitude of the impact of layoff announcements on stock prices.

The economic impact of the layoff announcement is likely to be closely related to the size of the layoff. As Worrel et al. point out, larger layoffs may signal more negative information and may be perceived to be associated with increased costs such as severance pay claims. Thus the percentage of the workforce laid off will be used as a predictor variable in modelling the impact of layoff announcements on stock prices.[2]

The other factor which affects the magnitude of the impact of the layoff announcement on stock prices is the degree to which the announcement has been anticipated. This, in turn, will be a function of whether investors have received prior signals which lead them to believe that layoff announcements

2. It is possible that the occupational level of the employees laid off may also affect stock prices. For example, the layoff of production employees may have a greater immediate impact than the layoff of clerical workers or management. Unfortunately, we were unable to model this due to the lack of information. Of the newspaper articles obtained, 58% gave no information about the occupational level of the employees laid off. In 7% of the reports it was clear that only production employees were laid off, and non-production employees were laid off in 16% of the cases. Plant closings accounted for 7% of the articles studies, whereas in 13% of the articles it was clear that a mixture of production and non-production employees were laid off.

may occur. A common precursor of layoffs is poor earnings performance by the firm, perhaps due to decreased demand for the firm's products. Thus, we use the percentage change in the preannouncement annual earnings per share as a variable which may influence the magnitude of the impact of layoff announcements on stock prices. Although it would be preferable to use an earnings figure more contemporaneous with the layoff announcement, companies announce earnings, at most, on a quarterly basis. The use of such quarterly figures could bias results due to the strong seasonal nature of many firms' earnings.

The annual percentage change in earnings per share (EPS) and the percentage of the workforce laid off had skewed distributions. Logarithmic transformations were performed on these variables, but skewness remained. Therefore, following the advice of Tabachnick and Fidell (1989: 84), we dichotomized these variables. The annual percentage change in earnings per share was dummy coded with 1 reflecting a negative change in EPS and 0 a positive change in EPS. The percentage of the workforce laid off was dummy coded by performing a median split with 0 representing low layoff percentages and 1 high layoff percentages.

Hierarchical regression is used to examine the factors that influence the criterion variable, the level of abnormal return.[3] The dummy variable representing the percentage change in annual earnings per share (EPS) is entered in the first step as a control variable, and the dummy variable representing the layoff percentage is entered in the second step.

Another variable which may affect individuals' expectations regarding layoff announcements is prior history of layoffs. In non-recessionary times, many firms have policies of stable employment. An initial layoff by such firms may shatter perceptions of the firm as a stable employer and lead people to believe that future layoffs are possible. Thus, when examining the effect of layoff announcements over our sample period of January 1989–August 1992, we will consider whether sample firms have had recent previous layoffs. This will be done by comparing the magnitude of the stock price effect for various groups of sample firms: the entire sample of layoffs over the January 1989–August 1992 period, and a subset which includes only firms which made no layoff announcements in 1988.

3. Since there is no theory which specifies that the impact of layoff size on share price must be linear, another hierarchical regression was run which allowed for non-linearity via a squared layoff percentage term. Untransformed values of the layoff percentage were used in this regression since it makes little sense to square a dummy variable. The dummy variable representing the change in earnings per share was entered in the first step as a control. In the second step, layoff percentage was entered, and layoff percent squared was entered in the third step. As the squared term was not significant, the results of this regression are not reported here, but are available from the authors on request.

Within each of the groups we will also compare the effect of the initial layoff announcement made by firms during the January 1989 to August 1992 period to the effects of subsequent announcements made by firms during the same period. Because of the signalling effect, it is expected that a firm's initial announcement will have a larger impact on stock prices than would subsequent announcements.

DATA

Sample

The names of Canadian companies announcing layoffs, and the dates of such announcements, were obtained by searching the *Canadian Business Index* (CBI) for the period January 1989 to August 1992. Because the CBI covers many publications which may not be read by the majority of stock market investors, only those announcements made in a major business newspaper, *The Globe and Mail*, were included in the sample. This is consistent with the approach followed by Worrell et al. who selected their sample from *The Wall Street Journal*.

There were 180 layoff announcements in *The Globe and Mail* over the period studied. Forty-three of these announcements were excluded from the sample, either because the company's stock was not publicly traded (a total of 29 companies) or because the company's stock traded too infrequently for valid parameter estimation (a total of 4 companies). The final sample consists of 137 layoff announcements made by 57 companies.

Data Collection

Daily stock prices and market index price information were obtained from FRI Incorporated. Information regarding the size of the layoffs and the company's earnings were obtained from newspaper articles and the Financial Post Card Service, respectively.

RESULTS

The descriptive statistics indicate the severity of the recession during the period studied. Of the 137 layoff announcements, 29 (21%) occurred in 1989, 35 (26%) in 1990, 50 (36%) in 1991, and 23 (17%) occurred between January and August 1992. The average percentage of the workforce laid off was 6.72%. The average annual change in earnings per share was -615.72%.

The estimates of b_j from equation 2 are given in Table 1.

TABLE 1

Estimated b Values from Equation 2

Company	*b*	*Company*	*b*
Abitibi-Price	0.84	Imperial Oil	0.33
Air Canada	1.42	Inco	1.15
Alcan	1.08	Ivaco	0.43
Bell Canada	0.95	Labatt	0.43
Bombardier	0.71	Lawson Marden	0.14
Brunswick M&S	2.03	MacMillan Bloedel	0.94
Budd	0.06	Magna	1.08
Bow Vally Ind's	0.38	Midland Doherty	0.55
Canadian Marconi	0.55	Mitel	2.74
Cdn Pacific Forest Prod.	1.28	Molson	0.88
Canam Manac	0.39	National Bank	1.36
Canfor	1.26	National Sea Products	0.10
Celanese	0.42	Northern Telecom	1.62
Central Guarantee Trust	0.99	Petro Canada	0.53
Cominco	1.67	Potash Corp.	0.96
Cognos	0.76	PWA	1.36
Dofasco	0.49	Repap	0.83
Dominion Explorers	1.76	Rio Algom	0.10
Domtar	0.70	Seagrams	0.81
Denison Mines	0.29	Shell Canada	0.36
Dominion Textiles	0.54	SNC	1.14
Dylex	0.33	Southam	0.35
Fish. Prod. Intl (FPI)	0.85	Stelco	0.41
Ford Canada	0.26	Torstar	1.11
Gandalf	0.54	Wardair	0.38
Giant Yellowknife	-0.12	Westmin Resources	1.92
Gulf Canada Resources	1.90	Woodwards	0.68
Hayes Dana	0.33	Xerox Canada	0.20
Hudsons Bay Co.	0.74		

Estimates of the impact of layoff announcement on stock prices (AAR's) are given in Table 2. Part A of Table 2 shows estimates based upon all layoff announcements made by companies over the January 1989–August 1992 period; Part B shows estimates based on only the first layoff announcement for each company during this period.

The results in the first column show the estimate for all layoffs which meet the above criteria. Columns 2 through 4 screen *out* the following:

TABLE 2

Estimated Impact of Layoff Announcements on Share Prices

	Full Sample	*Full Sample less cos. with layoffs in 1988*	*Full Sample less cos. with same day announce-ments*	*Full Sample less cos. with layoffs in 1988 or same day announce-ments*
PART A: Initial and Subsequent Layoffs during Jan. 89–Aug. 92.				
Estimated Impact (AAR)	-.0060	-.0062	-.0051	-.0052
t statistic	-1.93***	-1.82**	-1.55*	-1.44*
Wilcoxon statistic	-2.36***	-2.13***	-2.14***	-1.91**
Sample size	137	124	123	111
PART B: Initial Announcements during Jan. 89–Aug. 92.				
Estimated Impact (AAR)	-.0101	-.0104	-.0091	-.0094
t statistic	-1.86**	-1.82**	-1.60*	-1.55*
Wilcoxon statistic	-1.97***	-1.88**	-1.98***	-1.88**
Sample size	57	54	51	48

*** significantly different from zero at the .05 level in a two-tailed test.
** significantly different from zero at the .10 level in a two-tailed test.
* significantly different from zero at the .20 level in a two-tailed test.

Column 2: layoff announcements made by companies which had announced layoffs in 1988

Column 3: layoff announcements which occurred on the same day as another announcement by the same firm

Column 4: announcements screened out in columns 2 or 3

All of the estimated impacts in Table 2 are negative and statistically significant at at least the 20% level in two-tailed tests using either *t* or Wilcoxon statistics. The estimated impacts range in magnitude from -.0052 to -.0101. This means that stockholders lose .5 to 1% of the value of their stock during the two-day period surrounding a layoff announcement. This represents an annual loss of over 60%. Thus, the loss experienced by shareholders is economically, as well as statistically, significant.

Some interesting patterns are revealed in Table 2. First, there is support for signalling theory – the impact of a company's initial layoff announcement during the study period (Part B) is consistently .4% greater than the average impact of all announcements over the same period (Part A).

Similarly, when companies which made layoff announcements in 1988 (the year preceding the study) are eliminated (column 2), the impact is greater than that in column 1 where these companies were not eliminated. The small difference in the magnitude of the impact is likely due to the small number of companies (3) making layoff announcements in 1988.

Finally, columns 3 and 4 show the importance of screening out companies that made other announcements at the same time as the layoff announcement – something not done by Worrell et al. Approximately 10% of the impact estimated in columns 1 and 2 appears to be due to factors related to the layoff announcement.

The results of the hierarchical regression are given in Table 3. We first regressed average abnormal return (AAR) on change in earnings per share (EPS). For the next step we entered layoff percentage.

TABLE 3

Hierarchical Regression Results

	Unstandardized coefficient	*Standardized coefficient*	
Control Variable			
EPS % Change	.01	.18	
R^2			.02
F			1.28
Predictor Variable			
Layoff %	-.02*	-.28*	
R^2			.10
ΔR^2			.08
F change			4.25*
F			2.81†

†p = .07 * $p \leq .05$ two-tailed

The results of the hierarchical regression indicate that the percentage change in EPS does not significantly affect abnormal returns. However, the percentage of the workforce laid off is a significant predictor. On average, over the two days around the announcement, share prices decline by .02%

more for large layoffs as compared to small layoffs. This means that large layoffs have a more negative impact on share prices.

DISCUSSION

Overall, our results show that layoffs have a negative impact on corporate stockholders. Consistent with the findings of Worrell, Davidson, and Sharma (1991), we found that larger layoffs have a more negative impact. Unlike Worrell et al., we distinguished between initial and subsequent layoff announcements and found that it is the initial layoff announcement that has the greatest impact on stock prices, that is, investors react more negatively to the first layoff announcement than to subsequent layoff announcements.

In contrast to Worrell et al., we did not find poor earnings performance to have a significant impact on stock price reaction to layoff announcements. Furthermore, our results show the importance of noticing announcements of events other than layoffs which may occur around the layoff announcement and affect the measured impact of the layoff announcement.

Hardy (1990) argues that there are hidden costs associated with downsizing that could translate into long-term costs, inhibit recovery, and threaten the organization's survival. Perry (1988) contends that layoffs are high-cost rather than least-cost strategies and that management should consider alternative human resource strategies for dealing with organizational decline. The findings of our study are consistent with these observations. Our results suggest that the tendency to rely on layoffs as the major cost cutting strategy (Greenhalgh et al. 1988) has negative repercussions for even the group of constituents that it is commonly believed would benefit from such measures.

The results of this study suggest that managers need to be more creative in dealing with cost cutting and increasing productivity. Greenhalgh, Lawrence, and Sutton (1988) suggest that alternative workforce reduction strategies such as transfer, early retirement incentives, and work sharing have a less negative effect on the organization's employees. It may be that these human resource strategies also have a less negative effect on shareholders.

CONCLUSIONS

It is frequently believed that investors benefit from cost cutting by organizations and that employees are the ones who suffer the negative

consequences. The results of this study suggest that managers need to be cautious when contemplating layoffs because layoffs are not viewed positively by investors. Moreover, managers should be especially wary of implementing large-scale layoffs as these are viewed more negatively by investors. Further research is required to determine if these results are applicable in non-recessionary periods. It would also be of interest to test whether Greenhalgh et al.'s (1988) suggested strategies (e.g., transfer, work sharing, early retirement) have a less negative impact on shareholders than do layoffs.

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RÉSUMÉ

L'impact des licenciements sur les actionnaires

Il est de croyance populaire que les lienciements sont bénéfiques pour les investisseurs et que ce sont les employés qui subissent le fardeau des réductions corporatives. En fait, il y a peu de recherche sur le sujet, et celle qui existe vise surtout des firmes américaines. De plus, la recherche existante peut être biaisée par le fait qu'elle fait des moyennes de réactions aux réductions en temps de récession et en temps de prospérité. On sait très bien que les réactions peuvent varier entre ces deux périodes.

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Cette conclusion infirme la croyance populaire que les actionnaires profitent des réductions corporatives impliquant des licenciements. Ajoutant ici les conclusions d'autres études à l'effet que les employés sont affectés négativement par les licenciements, la preuve indique que les gestionnaires doivent trouver des voies alternatives pour demeurer compétitifs vu que les licenciements ne bénéficient ni aux employés ni aux actionnaires.