Mass Layoffs: When and How Do They Affect Customer Satisfaction?

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Downsizing seems to be one of the most appealing cost-cutting strategies to companies all around the world. Having emerged as a response to the economic slowdown of the 1980s (Baumol et al, 2003), this controversial management practice remains a topic of highest prominence even today. In fact, between 2000 and 2008 (i.e., even before the financial crisis) more than 10 million U.S. employees lost their jobs in over 52,000 mass layoff events (Bureau of Labor Statistics 2009).

Interestingly, previous research shows that the attempt to improve performance through mass layoffs often fails. In search for explanations, researchers have begun to examine the effects of mass layoffs (often referred to as "downsizing") on customer satisfaction and found first evidence of a negative relationship. As Chadwick et al (2004, p. 406) note, "The general consensus among researchers over the last two decades is that organizational performance is as likely to suffer as it is to improve after downsizing." In this context, marketing researchers have focused on understanding the effect of downsizing on customer satisfaction, with first studies reporting a negative relationship (Lewin, 2009; Lewin and Johnston, 2008; Lewin et al, 2010, e.g.).

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We argue that this issue may well be more complex. Drawing on a theoretical argument on the relationship between firm productivity and customer satisfaction by Anderson et al (1997), we propose that it will mostly depend on environmental factors whether downsizing has a positive or a negative effect on customer satisfaction. Consider for instance the customer involvement into the product category as a context factor. If customers are highly interested in a product category they are much more likely to notice

1. the downsizing itself and
2. resulting changes in product performance.

Hence, downsizing is much more likely to have a negative effect on customer satisfaction in this situation. Similarly, we expect that the negative effect of downsizing on customer satisfaction is stronger for service firms, organizations low on organizational slack and organizations where labor productivity is already high before the downsizing. Further, we expect a more pronounced effect on satisfaction if the mass layoffs are conducted proactively to further increase profits vs. reactively to help overcome an organizational crisis. Finally, due to possible effects of downsizing on innovative capabilities, we expect that the negative effect of downsizing on satisfaction is stronger in industries characterized by high R&D intensity.

To test our hypotheses, we combine data from three sources.

1. We use data from the American Customer Satisfaction Index (ACSI) to measure our focal variable customer satisfaction.
2. We measure organizational downsizing as well as most context factors using Compustat data.
3. To measure consumer industry involvement, we collected survey data.

The original sample for our study contains all companies listed in the ACSI. We excluded companies that either were not incorporated in the United States (e.g., BMW) or provided customer satisfaction data on the brand instead of the firm level (e.g., Chrysler Corporation, for which the ACSI differentiates between Chrysler and Dodge-Plymouth). We then matched these companies with financial data and employment information of Standard and Poor's Compustat, excluding companies that were not unequivocally listed on Compustat or did not provide three consecutive years of complete data. Also, we included data only up to the year 2008 in order to exclude any exceptional effects of the recent world economic crisis.

We used two measurement approaches for determining whether a firm had done downsizing or not.

1. Consistent with previous research we defined a dummy variable that indicated whether the total number of a firm's employees had gone down compared to the previous year by 5% or more. Based on this, we were able to identify more than 180 downsizing events.
2. We created a second narrower downsizing variable. Again this was a dummy variable, but to consider an employee reduction as downsizing it was additionally required that the mass layoff was also reported in a corresponding newspaper article in a major business journal.

Using various panel regression estimators on our data, we find a negative effect of downsizing on customer satisfaction. However, it is not statistically significant. As hypothesized we can report that the negative effect of downsizing on customer satisfaction is generally more pronounced if a company has low organizational slack, and if it operates in an R&D-intensive industry. Finally, as predicted, when using the broad downsizing operationalization there is a negative effect of downsizing in markets that customers feel highly involved with.

Our research makes at least three contributions to the discipline.

1. We identify situations in which the effect of downsizing on customer satisfaction is more pronounced.
2. By employing longitudinal data, our study allows us to make stronger causal claims regarding downsizing's effect on performance compared with previous research. This is particularly important, because a negative association between downsizing and customer satisfaction can also arise in cross-sectional data through an effect of customer satisfaction on downsizing. In fact it is quite plausible, that firms with unsatisfied customers will encounter performance problems that might entice them to engage in downsizing.
3. Our study also contributes to downsizing research by demonstrating how satisfaction outcomes of downsizing may explain whether a downsizing project is successful or not. By showing that downsizing may have an indirect effect on financial performance via customer satisfaction, our findings provide a possible explanation of why so

many downsizing projects fail. Thus, we also contribute to research on the so-called "hidden costs" of downsizing (Buono, 2003) by providing evidence that these hidden costs actually translate into monetary disadvantages.

The full paper is available on request from the authors.

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