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Disclosure strategies and investor reactions to downsizing announcements: A legitimacy perspective

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ABSTRACT

In this paper, we focus on a relatively underexplored aspect of sustainability—workforce reductions. We investigate the determinants and consequences of the decisions made by French firms to use press releases in order to announce downsizing operations. We also examine whether the content of press releases has an impact on investor reactions to downsizing announcements. Particularly in the French context, downsizing operations reflect negatively on corporate social responsibility with respect to employees, and we anticipate that French managers will use disclosure strategies to counter a potential legitimacy threat. Our sample consists of 227 downsizing operations announced between 2007 and 2012 by 119 French listed firms. We find that the disclosure of press releases is driven by both contextual and legitimacy factors. We also find that press releases are associated with more negative reactions to downsizing announcements than when there is no press release, particularly in the case of proactive operations (i.e., implemented by firms with improving performance). A content analysis of press releases indicates that firms, on average, engage in a reactive impression management strategy in their disclosure that consists of attributing downsizing operations to external factors. Moreover, investors penalize the use of proactive arguments, particularly when they are used to justify proactive operations. Overall, our results show that, in the French case, disclosure strategies and their consequences on the financial markets relate to a legitimacy perspective.

1. Introduction

Organizational sustainability includes the economic-financial, environmental, and social aspects of organizations (e.g., Jabbour and Santos, 2008). However, to date, most research in the sustainability domain focuses on the environmental aspect of sustainability as opposed to its social dimension (Sharma and Ruud, 2003). And while recent literature on integrated reporting in sustainability accounting (e.g., Baboukardos and Rimmel, 2016; Melloni et al., forthcoming) does consider different CSR dimensions, specific categories are not examined in-depth.

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In contrast, in this paper we explore the social issue of workforce reductions. Consistent with Wilkinson (2005), we argue that downsizing operations[1] have an adverse impact on sustainability and we note that these operations have been the subject of much controversy. More specifically, several studies note that downsizing operations are perceived by society as a breach of the social contract between organizations and society (e.g., Mäkelä and Näsi, 2010; Van Buren, 2000; Vuontisjärvi, 2013). Accordingly, the issue of workforce reductions falls within the domain of corporate social responsibility (CSR)/sustainability research since the operations have adverse societal consequences, particularly for employees. From an ethical perspective, downsizing operations can also be seen as a questionable business undertaking (Vuontisjärvi, 2013) and are generally implemented in order to improve firm efficiency and to maximize value for shareholders. However, for employees and the local community, downsizing operations usually mean significant losses that can be difficult to support (Mäkelä and Näsi, 2010).

Such a breach of the social contract can have severe economic consequences for firms—for instance because of potential strikes or boycotts (e.g., Hunter et al., 2008), which could destroy value for shareholders through lost customers and revenues.[2] This would be especially true for "proactive" downsizing operations as they are considered less ethically justifiable (Van Buren, 2000) because they are not justified by apparent financial needs (Love and Kraatz, 2009). Downsizing operations can thus be viewed as negative social events (e.g., Barclay et al., 2005; Flanagan and O'Shaughnessy, 2005; Leana and Feldman, 1988) that create legitimacy threats for organizations. Consequently, companies facing legitimacy threats may use disclosure strategies to alter perceptions about the legitimacy of the organization (e.g., Beelitz and Merkl-Davies, 2012; Cho, 2009; Cho and Patten, 2007). If this is the case, we would expect to find that, when companies disclose the logic behind downsizing operations, they would be more likely to make them appear more reactive (or less proactive) than they are in reality.

In addition, prior research examines the impact of downsizing announcements on the reaction of financial markets (e.g., Chalos and Chen, 2002; Elayan et al., 1998; Hillier et al., 2007; Lee, 1997) and generally shows a negative investor reaction (e.g., Chen et al., 2001; Elayan et al., 1998; Hillier et al., 2007; Lee, 1997; Lin and Rozeff, 1993; McKnight et al., 2002; Ursel and Armstrong-Stassen, 1995; Worrell et al., 1991). Evidence also suggests that the reason *why* (proactive or reactive) downsizing operations occur influences financial market reactions. However, while these prior studies primarily focus on code-law countries and adopt an economic perspective to explain results, we argue that the investigation of downsizing operations in more stakeholder-oriented countries requires consideration of other perspectives such as their potential threat to corporate legitimacy.[3]

In this study, therefore, we examine the determinants and consequences of the decisions made by French firms to use press releases in order to announce downsizing operations, through a national lens and by adopting a legitimacy perspective. We also examine whether the *content* of the press releases has an impact on investor reactions to downsizing announcements because the analysis of disclosure strategies aligned with such announcements highlights the potentially important role of disclosure in influencing investor response to downsizing announcements. We specifically focus on the French context where the need to justify and legitimate downsizing operations through disclosure strategies seems particularly strong. The French legal system protects workers and makes it difficult and costly for firms to dismiss workers (Cascio, 2005), and France is historically known for its strong conflicts between managers (or shareholders) and employees. While cooperation between both parties has been improving to some extent, the country's protest culture – documented by a high strike rate – is still prevalent and leads to high exposure of downsizing operations in the media.[4] Further, and importantly from a legitimacy perspective, Jung et al. (2015, p. 2064) argue that "the nature of employment reduction in France is distinct from 'offensive' layoffs more common in the USA in the last three decades." They note that in the U.S. firms "increasingly rely on employee layoffs [...] to improve financial performance in the context of increased pressures from shareholder value-driven institutional investors," while in France, poor performance is the key driver to employment reduction (Jung et al., 2015, p. 2062–2063). Accordingly, proactive operations in France are often viewed as an "injustice" creating political tensions and generating a need for communication. France is thus a unique setting to examine downsizing operations as these events constitute significant threats to firms. Examining 227 downsizing operations implemented between 2007 and 2012 by 119 French listed companies, we find that the disclosure of press releases to announce downsizing operations is driven by both contextual and legitimacy factors. With respect to the former, we find that press releases are more likely for firms that implement a downsizing for the first time during the period studied, and less likely when downsizing operations are implemented through layoffs rather than voluntary measures (e.g., early retirements, voluntary redundancy plans). With respect to legitimacy-related factors, we

[1] We use the term "downsizing operations" and "workforce reduction" interchangeably in the paper as we consider them synonymous. As we note in the methods section below, our sample of events includes downsizing operations related to both layoffs and voluntary reduction measures (such as voluntary retirement). We control for differences in these types of reductions in the analysis.

[2] An illustration is the 2001 consumer boycott on Danone, a French multinational food and beverage firm. While it was generating high profits, Danone announced a cut of 3000 jobs in Europe, including 1700 in France. This operation was seen as a "public outrage" (Hunter et al., 2008, p. 338) even by some politicians who ordered hospitals and schools to stop buying Danone products. The Danone logo was modified to include the slogan "Human beings are not yogurts". Despite Danone denying the impact of the boycott and strikes on firm performance, a serious decline in the company's sales and market capitalization has been reported by financial analysts and the media.

[3] In the legitimacy perspective, the target audience for disclosure is wider than in the economic perspective and includes several stakeholders (e.g., customers, employees, etc.).

[4] For example, on October 5th, 2015, Air France-KLM's angry employees interrupted a meeting in which managers and employee union representatives were discussing a new large downsizing operation. This operation caused both violent protests and actions against Air France-KLM's CEO and Human Resources Director and this incident was subject to much international media exposure. French President François Hollande denounced this violence as "unacceptable and bad for France's image". He added that "social dialogue is important, and when it is interrupted by violence and disputes take on an unacceptable form, it can have consequences for the image and attractiveness [of the country]".

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