NAVIGATING RETRENCHMENT IN 2025: LEGAL COMPLIANCE AND BEST PRACTICES

I. INTRODUCTION

The global employment landscape is being significantly reshaped in response to economic changes, technological advancements and strategic realignments in business operations. Since the beginning of 2025, over 830 companies across the globe have announced layoffs[1], with a ripple effect seen in several Indian entities, ranging from small-size to larger employers.

While certain employers have offered generous severance packages to support affected employees, there are specific instances where the employer has faced public scrutiny and legal challenges for allegedly failing to adhere to applicable Indian labour laws. The consequences of non-compliance extend beyond legal penalties to reputational damage and the loss of employee confidence, which can significantly impact talent retention, stakeholder trust and future business prospects.

In this context, it is essential for employers to navigate workforce restructuring not only in compliance with employment laws but also with empathy and fairness. This article provides an overview for organisations navigating the complex legal landscape of workforce reductions in India, with the aim of safeguarding organisational integrity and employee well-being.

II. OVERVIEW OF THE LEGAL FRAMEWORK

A. Understanding the Terminology: "Layoff" vs. "Retrenchment"

As a general approach, the term "layoff" in the employment law space typically refers to a temporary or permanent termination of employment by an employer, usually due to cost-cutting measures, organisational restructuring or economic downturns. The reasons for layoff are generally unrelated to the employee's performance and are often positioned as part of workforce optimization efforts.[2] However, under Indian labour laws, the term "layoff" carries a specific legal definition. The federal Industrial Disputes Act, 1947 (the "**ID Act**") defines layoff of workmen employees (discussed later) as an "*inability, failure, or refusal of the employer to provide employment to an employee whose name has been mentioned in the muster roll of its industrial establishment and who is not retrenched due to lack of power, coal, raw materials accumulation of stocks, breakdown of machinery or natural calamity for any other relevant reason*."[3] In simple terms, a layoff under Indian employment laws is a temporary suspension of work and does not result in termination of the employer-employee relationship.

[1]Companies that announces major layoffs and hiring freeze, INTELLIZENCE, March 19, 2025, https://intellizence.com/insights/layoff-downsizing/major-companies-that-announced-mass-layoffs/
[2]Laid Off – Definition, Reasons, Alternatives to Layoffs, Corporate Finance Institute, December 11, 2022, https://corporatefinanceinstitute.com/resources/career/laid-off/
[3]Section 2(kkk), Industrial Disputes Act, 1947.

What is commonly referred to as "layoff" globally, would in the Indian legal context be considered as "retrenchment" for workmen. The ID Act defines retrenchment as "*the termination by the employer of the service of a workman* ***for*** *any reason whatsoever, otherwise than as a punishment inflicted by way of disciplinary action but does not include (i) voluntary retirement; (ii) retirement on attaining the age of superannuation if one is stipulated in the employment letter or company policy; (iii) non-renewal of an employment contract upon its expiry; or (iv) continued ill health of the employee*."[4] Interestingly, termination of services of an employee due to unsatisfactory performance is also considered as retrenchment under the ID Act.

This distinction between "layoff" and "retrenchment" under Indian labour law is crucial for determining applicable legal compliances, including employee entitlements, which the employer is required to fulfil.

B. The Dual Regulatory Framework under Indian Labour Laws

In India, employment laws operate under the dual framework of federal and state laws. At the federal level, the ID Act regulates the resolution of industrial disputes between employers and employees. An employee is governed by the provisions of the ID Act, if they are classified as a "workman"[5]. However, in addition to satisfying the definition of a workman, other parameters like the nature of work, the type of industry etc., must also be satisfied. Under the ID Act, a workman employee who has completed 1 year of continuous service cannot be retrenched unless the employer, *inter alia*, (1) serves 1 month's prior notice in writing, stating the reasons for retrenchment, or pays wages in lieu of such notice; and (2) pays retrenchment compensation equivalent to the prescribed amount.[6] Additionally, the employer is required to satisfy certain administrative requirements including adhering to the 'last-in-first-out' principle and taking prior permission of the governmental authorities in certain cases.[7] Unless the cause of retrenchment falls within the exemptions listed under the ID Act, an employer is required to comply with these conditions when retrenching a workman employee.

At the state level, most businesses are also regulated under the Shops and Establishments Act ("**S&E Act**") of the respective states in which they operate. The S&E Act regulates the working hours, wages, leaves, and other statutory requirements of employees. These laws apply to commercial

[4] Section 2(oo), Industrial Disputes Act, 1947.
[5] Section 2(s) of the Industrial Disputes Act, 1947 defines workman as any person (including an apprentice) employed in any industry to do any manual, unskilled, skilled, technical, operational, clerical or supervisory work for hire or reward, whether the terms of employment be express or implied, and for the purposes of any proceeding under this Act in relation to an industrial dispute, includes any such person who has been dismissed, discharged or retrenched in connection with, or as a consequence of, that dispute, or whose dismissal, discharge or retrenchment has led to that dispute, but does not include any such person-(i)who is subject to the Air Force Act, 1950 or the Army Act, 1950, or the Navy Act,; or(ii)who is employed in the police service or as an officer or other employee of a prison, or(iii)who is employed mainly in a managerial or administrative capacity, or(iv)who, being employed in a supervisory capacity, draws wages exceeding ten thousand rupees per mensem or exercises, either by the nature of the duties attached to the office or by reason of the powers vested in him, functions mainly of a managerial nature.
[6] Section 25F, Industrial Disputes Act, 1947.
[7] Chapter VA of the Industrial Disputes Act, 1947.

establishments, ranging from multinational corporations and business operating in information technology (IT) sector to places of public entertainment like hotels, restaurants, theatres etc. While a "workman" under the ID Act is covered under the S&E Act, the S&E Act covers a broader category of employees, including apprentices and person working on contractual basis. Most S&E Acts mandate that employees who have completed a minimum period of employment (typically ranging from 3 to 6 months) must be provided at least 1 month's prior notice or payment in lieu if employment is terminated for convenience.

Therefore, this overlapping employee classification system requires careful categorisation to determine which legal framework applies to the employee's termination.

III. KEY COMPLIANCE AREAS

A. Employment Contracts vs. Applicable Labour Law

In India, the employment relationship is fundamentally governed by contractual terms mutually agreed between employers and employees. Most employment contracts include a "**termination for convenience**" clause, which allows either party to terminate the employment by providing the contractually stipulated notice or payment in lieu thereof. Employers often invoke this clause when an employee is terminated on account of business-related reasons such as cost-cutting, reorganisation, redundancy, etc. or for specific reasons such as employee performance issues.

However, when such termination is implemented, Indian labour laws, particularly the ID Act and the applicable S&E Act, supersede the contractual provisions to the extent they offer greater protection to the employee.

If an employee is not covered under the ID Act, their termination may still be governed by the relevant state's S&E Act provided they fall within the Act's scope. In such a case, the provisions of the applicable S&E Act will override the terms of the employment contract, to the extent they are inconsistent or less beneficial than the provisions of the S&E Act.

However, if an employee is covered by neither the ID Act nor the state's S&E Act (e.g., a Non-Workmen Employee), then their termination is purely governed by the terms and conditions of their employment contract.

B. Potential Consequences of Non-Compliance

Failure to comply with statutory requirements during termination processes can expose employers to a range of legal, regulatory and reputational risks. Affected employees have various avenues of recourse and may pursue the following legal remedies.

(i) Under the ID Act: If an employer fails to comply with the provisions of retrenchment, a workman employee may file a complaint under the ID Act, including for an unfair labour practice, which may carry monetary compensation or possible reinstatement repercussions.

(ii) Under the Indian Contract Act, 1872 ("**Contract Law**"): When non-workmen employees face improper termination, they can pursue civil remedies provided under Contract Law, which may include damages for breach of contracts and specific performance of notice periods.

(iii) Governmental Interventions: Mass retrenchments in violation of statutory requirements may trigger governmental and regulatory scrutiny. In these situations, the affected employees can file a complaint with the government authorities, triggering investigations, inspections and audits into the practices of the employer.

IV. RISK MANAGEMENT STRATEGIES AND BEST PRACTICES

Establishments can mitigate the legal and business risks associated with improper retrenchment by ensuring comprehensive pre-termination and consistent procedural compliance. Employers should conduct comprehensive reviews and analysis of all employment contracts and a proper classification of employees to determine whether they qualify as a "workman" under the ID Act.

Particular attention should be paid to severance computation, as errors in severance computation based on different wage components frequently trigger litigation. Companies should also maintain detailed internal documentation of the business rationale driving the retrenchment decision, including financial projections, records of performance improvement plan (particularly wherever the employee is being terminated for unsatisfactory performance), any analysis supporting the decision, and records of alternative measures considered before resorting to retrenchment.

In situations involving large-scale rightsizing, the employer should document objective, non-discriminatory criteria for determining positions which are to be eliminated, ensuring uniform implementation across departments and levels. Maintaining comprehensive records of the decision-making process can serve as key evidence in defending the company against potential discrimination claims.

V. WAY FORWARD

As the business landscape continues to evolve in 2025 in India, economic circumstances and business needs may compel more organisations to consider downsizing as a strategic necessity. In such circumstances, proper legal compliance during the process is not merely a regulatory obligation but a critical step towards preserving an organisation's credibility, reputation and long-term sustainability. In today's climate, compliance is not just a checkbox but a cornerstone of resilient and ethical leadership. By implementing thorough diligence and consistent application of policies, employers can manage necessary workforce adjustments while minimizing risks and maintaining stakeholder trust during challenging transitions.

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