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Labor Unemployment Insurance and Firm Cash Holdings

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ABSTRACT

This paper presents evidence that firms conserve cash to manage employees' perceptions of the risk of becoming unemployed. Employing a matched sample design and using state level changes in unemployment insurance (UI) benefits to proxy for unemployment risk, we test the hypothesis that cash holdings and unemployment risk are positively related. We find an economically and statistically significant association between decreases in cash holdings, following an increase in UI benefits (i.e., lower unemployment risk). Our findings are robust to alternative specifications and we find that the positive relation between cash holdings and unemployment risk is more pronounced for firms that are more labor intensive, have a high layoff propensity, have a higher fraction of low-wage workers, and are in industries with a higher fraction of UI recipients. Overall, our results are consistent with the idea that cash holdings are affected by not only shareholders but also other stakeholders: namely employees.

JEL classification: J01; G32; M54

Keywords: Unemployment risk; Stakeholders; Unemployment insurance benefits; Cash holdings; Employee welfare

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