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How does financial pressure affect firms?

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Abstract

This paper investigates the impact on company behaviour of increases in financial pressure. The best measure of this we find to be the ratio of interest payments to cash flow. An increase in this measure has a large negative effect on employment *controlling for* current and expected wages and demand. It also has a negative impact on pay rises and a small positive effect on productivity. These effects are identified by using as an instrument the inherited debt burden of the firm (2 or 3Â years lagged) interacted with the contemporaneous shift in the yield on Treasury bills.

JEL classification

J23; D21

Keywords

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Employment; Wages; Cash flow; Financial pressure

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