Labor leverage, financial statement comparability, and corporate employment

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ABSTRACT: We examine how labor-induced operating leverage shapes managers' decision to adopt more comparable financial statement. We hypothesize that firms subject to higher labor-induced operating leverage are more likely to adopt more comparable financial statements in order to facilitate more timely employment adjustment which reduces firm risk related to labor leverage. Consistent with our hypothesis, we find that proxies for labor-induced operating leverage, such as labor unions, labor intensity, and labor share are positively related to financial statement comparability. We also find that financial statement comparability increases the sensitivity of hiring to performance change, particularly, for negative operating performance, supporting our notion that financial statement comparability helps managers' timelier labor adjustment. Last, we examine whether the improved comparability prevents massive layoffs thanks to continuously more timely employment adjustment. Consistent with our prediction, we find that comparability reduces the likelihood of large-scale layoffs.

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1. Introduction

Recent literature in financial statement comparability (e.g., De Franco, Kothari, and Verdi 2011; Kim, Kraft, and Ryan 2013; Chen, Collins, Kravet, and Mergenthaler 2018; Shane, Smith, and Zhang 2014) generally provides evidence that accounting comparability is beneficial to capital markets, including both equity and public debt markets and to merger and acquisition (M&A) deals. For example, De Franco et al. (2011) document that financial statement comparability is positively related to analyst coverage and earnings forecast accuracy while negatively related to earnings forecast dispersion, suggesting that financial statement comparability lowers the cost of stock analysts' acquiring and processing information, and increases the overall quantity and quality of public information. Chen et al. (2018) examine how financial statement comparability affects the performance of M&A activities and find that acquirers make better acquisition decisions when target firms' financial statement is more comparable with that of industry peer firms.

While most prior studies focus on the effects and consequences of financial statement comparability on various outcome variables, our knowledge is very limited to the determinants of financial statement comparability, particularly, how corporate operational characteristics affect managers' incentives to adopt financial statement comparability. In this paper, we attempt to fill this void in the literature by examining how financial statement comparability is affected by labor induced operating leverage (hereafter, labor leverage) which recently attracts a lot of attention from the accounting and finance literatures (e.g., Donangelo, Gourio, Kehrig, and Palacios 2019; Favilukis, Lin, and Zhao 2020).

Sticky employee wages facilitate a negative economic shock leads to higher labor leverage. During the economic downturn, employee wages decline more slowly compared to

the sales decline resulting in higher labor expenses relative to the firm size which potentially would be detrimental to firm value. For example, labor leverage increases credit risk as pre-committed wage payments make interest payments riskier during economic downturns. Consistent with this perspective, Favilukis et al. (2020) show that firms with high labor leverage are less likely to issue debt due to the increased credit risk arising from labor leverage, suggesting that labor market friction is the first-order effect on credit market friction. Despite the importance of labor leverage in various corporate decisions documented in recent finance studies, empirical evidence on the importance of labor leverage in managers' financial reporting choices is still scarce.

This study examines whether firms subject to higher labor leverage are more likely to adopt more comparable financial statements. Higher labor leverage generally leads to managers' greater incentives to reduce inherent operating risk and thus we hypothesize that managers with higher labor leverage are more likely to adopt more comparable financial statements which facilitate their making better inferences about economic similarities and differences across firms. Financial statement comparability allows managers to compare their performance with other peers in the same industry more efficiently by improving information availability and lowering information asymmetry (e.g., Kim, Kraft, and Ryan 2013; Fang, Li, Xin, and Zhang 2016; Stallings 2017; Choi, Choi, Myers, and, Ziebart 2019. The effective comparison with industry peers allows managers to better predict their future performance along with economic events, resulting in timelier adjustment of their labor share. Given rigid nature of wages, we predict that managers would decrease risk related to labor leverage by reducing labor forces more quickly or not hiring additional labor forces to prepare for negative economic shocks during economic downturn. Furthermore, managers have another incentive to increase the financial statement comparability as it encourages rank-and-file

employees to more easily accept managers' decisions to reduce labor forces when their firms' earnings performance is more comparable to peer firms in the same industry.

To test our hypothesis, we first examine the relation between labor leverage and financial statement comparability. We measure labor leverage in four ways. Labor intensity, the first proxy for labor leverage, is measured as the number of employees scaled by total assets (e.g. Hilary 2006). Maintaining a labor force involves certain costs which are largely fixed in nature because of costly hiring and training costs and continuing wage expenses. As the fixed portion of labor costs is more substantial for firms with higher labor intensity, the mismatch between wage payments and corresponding revenues becomes more severe, leading to the higher labor leverage (e.g., Donangelo et al. 2019; Jung, Lee, Weber, and Yang 2020). The second proxy for labor leverage is labor union strength. The literature documents that stronger labor unions increase operating leverage by making wages stickier and layoffs costlier (e.g., Chen et al. 2011; Jung et al. 2020). Our third proxy for labor leverage is labor share. Donangelo et al. (2019) theoretically suggest and empirically validate that labor share, the relative size and inflexibility of labor expenses, leads to a form of operating leverage to firms. Following Donangelo et al. (2019), we measure labor share as the ratio of imputed labor expenses to value-added. Lastly, to capture various aspects of labor leverage, we create the composite measure of labor leverage based on aforementioned three individual proxies.

We measure financial statement comparability following De Franco et al. (2011) who propose an approach to measuring comparability based on the similarity of the mapping between earnings and stock returns. De Franco et al. (2011) define the accounting system as a function which maps the economic events to the financial statements. Our primary comparability measure uses the industry median of pairwise comparability estimated for all the peer firms in the same industry. As alternative proxies, we also employ the industry mean

of pairwise comparability and cash flow based comparability measure, similar to Barth et al. (2012).

Based on 44,400 firm year observations from 1992 to 2017, we find that all proxies for labor leverage are positively associated with financial statement comparability, suggesting that firms with higher labor leverage tend to adopt more comparable financial statements. To control for the potential timing bias in our model, we also conduct three additional tests by including the lagged-comparability measure as an additional control variable (Hamm et al. 2018; Wooldridge 2000), and using only every fourth year of observations and four year ahead comparability measure to eliminate the timing overlap between comparability variable and labor share proxies (Imhof et al. 2018). We confirm that our results are robust to these alternative specifications.

To mitigate the endogeneity concern that unobservable firm characteristics affect both labor leverage and comparability, we employ right-to-work (RTW) regulation as an exogenous shock to a change in comparability measure. The literature suggests that this exogenous shock significantly decreases employees' bargaining power, and thereby we expect that managers will face relatively lower level of labor leverage. Consistent with our main results and our prediction, we find that comparability is significantly lower for firms in states after adopting RTW regulations, suggesting that our results are not driven by the endogeneity concern.

To further strengthen our main results, we also implement several tests for cross-sectional variations in the relation between labor share and comparability. We expect that firms more subject to future negative economic shocks will have greater incentives to reduce risk arising from labor leverage and thus, to adopt comparable financial statements. Employing three proxies for the riskiness or volatility of business environments: stock return volatility (Chen et al. 2018), product market competition (Hamm et al. 2018), and firm-level

uncertainty based on the occurrence of risk-relevant terms in the conference call transcripts (Hassan et al. 2019), we find that the positive relation between labor share and comparability is more pronounced when firms are more likely to face future negative economic shocks.

Our hypothesis is based on the notion that managers are more likely to adopt financial statement comparability to facilitate timelier labor adjustments. To support our claim, we examine whether financial statement comparability facilitates firms' timelier labor adjustments, particularly during negative economic shocks. Consistent with our notion, we find that comparability indeed increases the sensitivity of hiring to performance change, particularly, when they have negative operating performance. These results suggest that comparability facilitates managers' efficient firing decision when their firm performance is poor.

If comparability promotes timelier labor decisions, the incidence of large-scale layoffs which is detrimental to firm value and firm reputation (Gunderson et al. 1997; Flanagan and O'Shaughnessy 2005) is less likely to occur while the incidence of timely fine-tuning labor decisions is more likely. Thus, we predict that comparability leads to the decrease in the incidence of large-scale layoffs and the increase in the incidence of fine-tuning employment decisions. Consistent with our prediction, we find a negative (positive) relation between comparability and the likelihood of layoff (fine-tuning of employment decisions).

Our study makes several contributions to the literature. First, it contributes to the literature on financial statement comparability by providing evidence that labor leverage affects managers' incentives to issue comparable financial statements. Different from most prior research which focuses on the consequences of financial statement comparability, our findings add to the literature by identifying labor induced operating leverage as a determinant of financial statement comparability and suggest that firm operational characteristics play an important role in shaping managers' decisions regarding the comparability of financial

statements. In addition, we contribute to the accounting literature that explores the benefits of financial statement comparability. By showing that financial statement comparability facilitates labor-related decisions in a timelier manner, we extend the growing literature that examines benefits of financial statement comparability on corporate decisions to employment decisions. Collectively, our findings corroborate that financial statement comparability is beneficial for firms who have concerns regarding labor leverage. Lastly, our paper adds to the literature on corporate labor. We find novel evidence on the effect of labor leverage on corporate financial reporting, enhancing our understanding of how labor issues influence firms' financial reporting strategy and choices.

The remainder of this paper proceeds as follows. Section 2 reviews the related literature and develops the hypothesis. Section 3 outlines the sample selection process and describes the measures and research design. Section 4 discusses the main findings. Section 5 presents additional analysis, and Section 6 concludes.

2. Literature review and hypothesis development

2.1. Literature review on financial statement comparability

Given the increase in business complexity and diversity of accounting method choice, standard setters and regulators have emphasized the importance of financial statement comparability as an enhancing characteristic of financial reporting and put considerable amount of efforts into improving the comparability of financial statements. Indeed, recently, both Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) highlight the importance of financial statement comparability, stating that comparability in financial reporting is the primary reason for developing accounting standards (FASB 1980, para. 112).

As a distinct attribute of financial reporting, financial statement comparability facilitates financial users to identify similarities and differences among firms and contributes to the information users' making better decision by increasing information availability, lowering information acquisition cost, and reducing information asymmetry. De Franco et al. (2011) introduce a novel measure of comparability and suggest that financial statement comparability improves overall quantity and quality of information environment — firms with high financial statement comparability have greater analyst coverage, more accurate analyst forecasts, and less dispersion among analysts. In this respect, a strand of literature examines the efficacy of comparability in improving the information environment of capital market participants such as shareholders, debtholders and managers. Stallings (2017) shows that greater financial statement comparability increases the information content of earnings and Choi et al. (2019) show that financial statement comparability improves stock price informativeness, supporting the notion that comparability decreases the stock investors' cost of gathering and processing firm-specific information. Similarly, Imhof, Seavey, and Smith (2017) report that comparability is associated with lower cost of equity capital. Kim, Kraft, and Ryan (2013) and Fang, Li, Xin, and Zhang (2016) find that financial statement comparability decreases credit spreads of bonds as well as loan spread of syndicated loans, implying that comparability alleviates information uncertainty around debt markets. Recently, Chen et al. (2018) report that greater financial statement comparability leads to more efficient acquisition decisions, suggesting that comparability enables managers to better understand and evaluate the target firms and fosters more efficient capital allocation. Recently, Ahn, Choi, and Yun (2020) find that financial statement comparability increases the marginal value of cash holdings by facilitating monitoring of managers. Overall, previous studies demonstrate that financial statement comparability is relevant to financial statement users'

understanding in firm's fundamentals and thus is demanded by capital market participants and regulators.

Despite the widely recognized benefits of financial statement comparability, there is scant literature on the determinants of financial statement comparability. Several studies examine whether and how the adoption of IFRS affects financial statement comparability (e.g., Barth, Landsman, Lang, and Williams 2012; Yip and Young 2012; Neel 2017). Some recent papers examine whether economic agents and institutional incentives affect firms' implementation of comparable financial statements. For instance, Francis, Pinnuck, and Watanabe (2014) find that audit firms play a role in shaping financial statement comparability. Specifically, financial statements are more comparable if both clients are audited by the same Big 4 auditors, suggesting that auditor style has a systematic effect on financial statement comparability. Endrawes, Feng, Lu, and Shan (2018) find that the size of audit committee and its financial and accounting expertise are positively associated with financial statement comparability. Imhof et al. (2018) show that higher competition induces managers to issue less comparable financial statements to avoid the proprietary costs of financial reporting.

Considering the important role of managers as economic agents in preparing financial statements and reporting incentives faced by them, understanding managers' strategic decisions of adopting financial statement comparability is essential although our knowledge on this issue is very limited. Particularly, the extent to which firm operational characteristics such as labor leverage affects managers' adoption of financial statement comparability is under-explored.

2.2. Literature review on corporate labor

Labor costs, the essential of business, not just represent a major source of expenses for firms[1], but embody an important source of operating leverage (i.e., the sensitivity of operating profits to economic shocks) since wages are stickier than firm's productivity (Danthine and Donaldson 2002; Lev and Zambon 2003). The inflexible nature of labor costs induces relatively higher share of fixed costs which are more sensitive to economic shocks, namely higher operating leverage.[2] Belo, Lin, and Bazdresch (2014) document that firms' hiring decisions incur high adjustment costs. Simintzi, Vig, and Volpin (2015) show that labor protections increase operating leverage by making labor costs more rigid, crowding out financial leverage. Chen, Kacperczyk, and Molina (2011) report that labor unions increase operating leverage by making wages sticky and layoffs costly and by intervening timely restructurings. Recently, Donangelo, Gourio, Kehrig, and Palacios (2019) suggest labor share as a proxy for labor leverage and find that it amplifies firm risk in a way analogous to financial leverage.

A growing body of finance and economics research sheds light on the role of labor leverage in shaping firm risk and management decisions. Favilukis and Lin (2016) and Chen, Kacperczyk, and Molina (2011) report that labor leverage leads to more volatile return on equity and higher cost of equity, respectively. Donangelo, Gourio, Kehrig, and Palacios (2019) and Rosett (2001) find that labor leverage induces firms to be exposed to higher level of systematic risk. Simintzi, Vig, and Volpin (2015) indicate that labor leverage affects firms' capital structure decisions by lowering financial leverage. Recently, Favilukis, Lin, and Zhao (2020) show that firms with high labor leverage issue less debt in response to the increased firm's credit risk arising from labor leverage. Collectively, the findings suggest that managers of firms with high labor leverage have enough incentives to reduce the costs and risks

[1] As an important factor of production, labor-related costs are economically significant (Hamm, Jung, and Lee 2018), which comprises more than half of gross domestic product (GDP) in the United States (Gollin 2002).
[2] Higher share of fixed costs increases operating profitability in positive economy shocks, while it decreases operating profitability in negative economy shocks.

brought by labor leverage. A number of recent studies (e.g., Chino 2016; Klasa, Maxwell, and Ortiz-Molina 2009) support this perspective by showing that managers moderate levels of payout policy and cash holdings in response to organized labor.

2.3. Hypothesis

We hypothesize that managers of such firms have greater incentives to reduce operating risk arising from labor leverage and thus, tend to increase financial statement comparability since it helps managers to better compare their performance with other peers in the same industry (Chen et al. 2018). Better comparison with the peer firms facilitates managers' timelier labor hiring/firing decisions, particularly during negative economic shocks, when operating risk due to labor leverage is higher.

Prior studies suggest that accounting information about sales, cost of goods sold, SG&A expense, and inventories reported in their financial statements is valuable for forecasting future demand and costs (e.g., Curtis et al. 2014). Since firms within the same industry are affected by similar economic conditions related to demand, supply, labor availability, and input costs, such peer firms' financial statement can improve manager's investment decisions by allowing managers to forecast the estimates of aggregate demand and supply conditions more accurately (e.g., Bonsall IV et al., 2013). Furthermore, peer firms' financial statements can reduce uncertainty about expected future cash flows from an investment project, resulting in lower adjustment costs such as less hiring/training new employees. By lowering adjustment costs, peer-firm financial statements help managers respond in a timely manner to changes in investment opportunities and make more efficient investment decisions (Bond and Van Reenen, 2007; Bloom et al., 2007).

We argue that if a firm's accounting information is more comparable to that of industry peers, the manager would be able to better predict its future performance and thereby decreases operating risk related to labor leverage by reducing labor forces more promptly to

prepare for upcoming negative economic shocks. Considering the sticky nature of wages, labor costs are only able to be adjusted by firing the existing employees or not hiring the new employees. In addition, financial statement comparability also helps rank-and-file employees more easily accept manager's decision to cut labor forces without disputes as it allows their better understanding firms' financial performance as well as industry-wide circumstances.

Therefore, we posit that for firms with high labor leverage, managers will issue more comparable financial statements, which leads to our main hypothesis.

Hypothesis: Ceteris paribus, a firm's labor leverage will be positively associated with financial statement comparability.

3. Sample, variables, and research design

3.1. Sample

We use Compustat and Center for Research in Security Prices (CRSP) databases to obtain our main variables such as labor leverage, financial statement comparability, and other firm characteristics. Data on analyst coverage and labor unions are obtained from the I/B/E/S and Union Membership and Coverage Database (www.unionstats.com), respectively. All continuous variables are winsorized at their 1 and 99 percent levels to reduce the effects of outliers on our results. The above procedure yields a final sample of 44,400 firm-years for the main analysis over the period of 1992 to 2017.

3.2. Variables

Financial statement comparability

De Franco et al. (2011) develop financial statement comparability measure by defining accounting system as a function that maps economic events to financial statements. If two firms have similar mappings between economic events and financial statements, then their accounting systems are viewed as comparable. Empirically, we employ stock returns to

proxy for firm's economic event and earnings to proxy for its reflection on financial statement:

$$\mathrm{E}(Earnings)_{it} = \alpha + \beta_1 Return_{it} \quad (1)$$

Financial statement comparability between two firms (i.e., firm *i* and firm *j*) is estimated as the negative value of the average absolute difference between the predicted earnings using two firms' mapping functions for the past 16 quarters as follows:

$$Comparability = -\frac{1}{16} \times \sum_{t=0}^{-15} |E(Earnings)_{iit} - E(Earnings)_{jit}| \quad (2)$$

The higher *Comparability* indicates higher financial reporting comparability between two firms.

Our main measure of financial statement comparability is defined as the median value of *Comparability* with all peer firms in the same industry (based on two digit SIC code), *CompAcct*. As alternative measures, we also use the mean value of *Comparability*, *CompAcctAlt1* and a measure developed by Barth et al. (2012), *CompAcctAlt2*, which maps net income into cash flow, instead of returns into earnings. To estimate *CompAcctAlt2*, we use following models (3) and (4):

$$\mathrm{E}(CF)_{it} = \alpha + \beta_1 NI_{it} \quad (3)$$

$$Comparability = -\frac{1}{16} \times \sum_{t=0}^{-15} |E(CF)_{iit} - E(CF)_{jit}| \quad (4)$$

Labor leverage

The smoothness of labor compensation relative to firms' cash inflows leads to a labor-induced form of operating leverage. Stated differently, the inflexible nature of labor costs results in relatively higher share of fixed costs which are more sensitive to economic shocks, namely higher operating leverage. We measure labor leverage in four ways. As the first proxy for labor leverage, we use labor intensity, *LaborIntensity*, defined as the number of employees deflated by total assets (e.g. Hilary 2006). Building and maintaining a labor force involves certain costs that are largely fixed in nature due to hiring and training costs and

paying wages. As the fixed portion of labor costs is substantial, the mismatch problem in the timing between wage payments and corresponding revenues becomes more severe, generating significant amount of adjustment costs related to labor. The significant amount of pre-committed wages is expected to result in high labor leverage for more labor-intensive firms.

The second proxy for labor leverage is *UNION*, a firm-level labor union strength based on the Current Population Survey. Labor union strength is widely considered as one of the determinants of labor-induced operating leverage. Chen et al. (2011) claim that labor unions increase operating leverage by making wages sticky and layoffs costly. *UNION* is calculated as the product of industry-level percentage of union membership and firm-level labor intensity, following the accounting literature (e.g. Hamm et al. 2018; Hilary 2006). This proxy hinges on the assumption that firm-specific union strength can be affected by both industry level union membership and the significance of labor at firm level. For example, even when a firm is operating in a highly unionized industry, if the number of employees is small, the effect of industry unionization on firm level labor union strength would be minimal.

The third proxy for labor leverage is extended labor share (hereafter *ELS*), which is based on imputed labor costs using Compustat data. Prior literature uses labor share as a proxy for labor leverage and shows that it amplifies firm risk in a way analogous to financial leverage (Donangelo et al. 2019). Specifically, labor share indicates the portion of labor expense relative to total value added and is calculated as labor expense divided by the sum of operating income before depreciation expense, change in inventory of finished goods, and labor expense. Of note, this measure (i.e. *ELS*) addresses the limitation that labor cost variable (Compustat item XLR) is only available for approximately 12% of all the Compustat firms. Specifically, following Donangelo et al. (2019), *ELS* is defined as follows:

$$ELS_{it} = \frac{LABEX_{it}}{OIBDP_{it} + \Delta INVFG_{it} + LABEX_{it}}, \quad (5)$$

where $LABEX_{it}$ = labor expenses, defined as the product of Compustat item EMP (i.e., the number of employees) and average annual labor cost per employee in the industry which a firm *i* belongs to during the year. In other words, $LABEX_{it} = \overline{WAGE_t^I} * \left(\frac{EMP_{it-1}+EMP_{it}}{2}\right)$. Here, $\overline{WAGE_t^I}$ is the average of $WAGE_{jt} = \left(\frac{XLR_{jt}}{\frac{EMP_{jt-1}+EMP_{jt}}{2}}\right)$ where firms j ∈ I and I denotes firm i's industry; $OIBDP_{it}$ = operating income before depreciation expense; $\Delta INVFG_{it}$ = change in inventory of finished goods.

Lastly, to mitigate measurement error in the above individual proxies and provide evidence based on an overall labor leverage metric, we construct a composite measure of the aforementioned individual proxies, *Labor_Comp,* by taking the average of the decile-ranked individual proxies (i.e. *LaborIntensity*, *UNION,* and *ELS*). Then, we employ these four measures (i.e. *LaborIntensity, UNION, ELS,* and *Labor_Comp*) for our main tests regarding the relation between labor leverage and financial statement comparability.[3]

3.3. Empirical Model

To examine the association between financial statement comparability and labor leverage, we estimate the following model (6).

$$\begin{aligned} Comparability_t = {} & \gamma_0 + \gamma_1 LaborLeverage_t + \gamma_2 Size_t + \gamma_3 DIVDUM_t + \gamma_4 MTB_t \\ & + \gamma_5 Leverage_t + \gamma_6 CFO5_t + \gamma_7 SALES5_t + \gamma_8 SalesGrowth_t \\ & + \gamma_9 Age_t + \gamma_{10} Big4_t + \gamma_{11} Analysts_t + \gamma_{12} Spread_t \\ & + \text{Industry Fixed Effects} + \text{Year Fixed Effects} + \epsilon, \end{aligned} \quad (6)$$

where *Comparability* represents either the main comparability measure (*CompAcct*) or one of two alternative measures (i.e., *CompAcctAlt1* or *CompAcctAlt2*). *LaborLeverage* refers to one of the four proxies for labor leverage (i.e. *LaborIntensity, UNION, ELS,* and *Labor_Comp*).

[3] For the sake of brevity, we report all additional analysis using our composite measure, *Labor_Comp.*

If a firm's labor leverage is positively associated with financial statement comparability, γ_1 should be positive and statistically significant, supporting H1. We add the following control variables representing potential determinants of comparability in the model (6): firm size (*Size*), dividend paying status (*DIVDUM*), market-to-book ratio (*MTB*), leverage (*Leverage*), the volatility of cash flows from operations (*CFO5*), sales volatility (*SALES5*), sales growth (*SalesGrowth*), and firm age (*Age*) (e.g. Francis et al. 2014; Imhof et al. 2018). In addition, we control for whether a firm engages a Big 4 auditor (*Big4*), analyst following (*Analysts*), and bid-ask spread (*Spread*) to capture information environment (e.g. Imhof et al. 2018). Lastly, industry fixed effects and year fixed effects are included to control for variations in financial statement comparability across industry and over year, respectively. Standard errors are clustered at firm-level to control for serial-dependence due to repeated firms in the sample.

4. Empirical Results

4.1. Descriptive statistics

Descriptive statistics for our main variables are presented in Table 1. All the variables are defined in more details in the Appendix 1. The mean value of our main measure of financial statement comparability (*CompAcct*) is -2.74, similar to that in prior literature (e.g. Imhof et al. 2018). The mean (median) value of the composite measure of labor leverage, *Labor_Comp*, is 6.16 (6.33). In addition, the sample firms are relatively large (mean *Size* = 5.74) and highly valued (mean *MTB* = 2.93). On average, 36% of the sample firms pay dividends. The mean value of sales growth, *SalesGrowth*, is 0.15, indicating that the sample firms are, on average, growing. The average firm age is 21.25 in our sample. Our sample firms are primarily audited by Big 4 audit firms (71%) and followed by 7.6 stock analysts.

In Table 2, we present Pearson correlations.[4] As expected, all the four labor leverage proxies are significantly and positively correlated, while still capturing somewhat different dimensions of labor leverage. All the comparability measures are also positively correlated with each other. As for the relation between labor leverage and financial statement comparability, all our proxies for labor leverage (*Labor_Comp*, *LaborIntensity*, *UNON*, and *ELS*) are positively and significantly correlated with all three comparability measures, suggesting that firms with higher labor leverage tend to adopt more comparable financial statements. These results provide preliminary support for our hypothesis.

Turning to control variables in our main model, we find that financial statement comparability measures are positively (negatively) correlated with firm size, dividends, market-to-book ratio, firm age, Big 4 auditors, and analyst coverage (leverage, the volatility of cash flow from operations, sales volatility, sales growth, and bid-ask spread). These results generally are consistent with prior studies (e.g., Kim, Li, Lu, and Yu 2016; Choi et al. 2019), indicating that financial statement comparability is higher (lower) for large, dividend paying, and old firms with better information environment (i.e., for firms with higher leverage and more volatile performance).

4.2. Main results: The relation between comparability and labor leverage

Table 3 shows the results from estimating the model (6). Panel A reports the results based on our first proxy for labor leverage, *LaborIntensity.* In the first column, we show the results using *CompAcct* as the dependent variable, while in the latter two columns, we present the results using alternative comparability proxies. We find that the coefficients on *LaborIntensity* are positive and statistically significant across all three columns, supporting our hypothesis that a firm's labor leverage is positively associated with financial statement comparability. The results when using other proxies for labor leverage such as *UNION* and

[4] Spearman correlation results which are similar with those of Pearson correlation are not tabulated for brevity.

ELS are presented in Panels B and C, respectively. Using these alternative labor leverage measures, we continue to find a strong and positive relation between labor leverage and financial statement comparability. Lastly, we report the results based on the composite labor leverage measure, *Labor_Comp,* in Panel D. Again, we find that the coefficients on *Labor_Comp* are significantly positive, consistent with our hypothesis. In sum, the results reported in Table 3 suggest that firms with high labor leverage tend to issue more comparable financial statements.

Turning to control variables, the coefficients are generally consistent with the correlation results and our prediction. We find that the coefficients on dividend paying status, firm age, and analyst coverage are significantly positive while the coefficients on leverage, the volatility of cash flow from operations, sales volatility, sales growth, and bid-ask spread are significantly negative. These results suggest that dividend paying, older, less leveraged, and less volatile firms and firms with better information environment generally provide more comparable financial statements.

4.3. Robustness tests

4.3.1 Addressing the potential timing bias in our main specification

Financial statement comparability measures are calculated over 16 quarters (i.e., four years), while labor leverage measures are estimated in the current year, indicating potential timing bias in our research design. To mitigate this concern, we conduct three additional tests.

First, we include four-year (i.e., 16 quarters) lagged comparability measure as an additional independent variable in our model (6) (e.g., Hamm et al. 2018; Wooldridge 2000). By adding this lagged comparability measure to the model, we control for the portion of current year comparability that are strongly correlated to past years' comparability. Table 4, Panel A reports the results after including this lagged-comparability measure as an

independent variable[5] and we find that the coefficients on *Labor_Comp* are still positive and statistically significant, suggesting that out main results remain unchanged after controlling for the potential impact of timing bias. Consistent with our expectation, we also confirm that the coefficients on the lagged comparability measure are significantly positive.

Second, to ensure there is no carry-over of information due to the rolling measurement period of comparability proxies, we re-estimate the model (6) using only every fourth year of observations (i.e. 1992, 1996, 2000, 2004, 2008, 2012, and 2016), following Imhof et al. (2018). Panel B presents the results using only every fourth year of data and shows consistent results with our main findings using the smaller sample. Lastly, we measure comparability at year $t+4$ and regress it on labor leverage at year t to further address the potential timing bias in model (6). The results presented in Panel C show that our inferences are robust to this modification.

Overall, our findings are consistent to these alternative specifications, supporting our hypothesis that a firm's labor leverage is positively associated with financial statement comparability.

4.3.2 Exogenous shock

Our results may be biased due to the endogeneity problem that there could be unobserved omitted factors that affect both labor leverage and financial statement comparability. Thus, in this section, we attempt to mitigate the effect of the endogeneity on our results. To mitigate the endogeneity concern, we may consider a change in variables specification, but this specification is not appropriate in our research setting due to the following reasons. First, our measure of financial statement comparability is calculated over rolling 16 quarters (i.e., four-year window) and thus, there is a strong correlation between the current period comparability and prior period comparability due to measurement period

[5] For brevity, we report the results only based on the composite measure of labor leverage, *Labor_Comp*, but the results based on other proxies for labor leverage are qualitatively similar. Results will be available upon request.

overlap amongst quarterly observations. Second, our measures of labor leverage are generally too stable over time to adopt the change in variable specification.

Instead, we utilize the state-level staggered adoption of right-to-work (RTW) laws as an exogenous shock to labor (union) strength (e.g. Chava et al. 2019; Matsa 2010) and thus, labor leverage in our setting. In the RTW states, workers can be employed in the unionized firm without joining the labor union. Workers are protected by the collective bargaining agreement negotiated by the union regardless of their registration or payment status with the union. Consequently, employers in these RTW states are easier to hire non-unionized employees and the union's bargaining power has been weakened because of their decreased resources. Given the fact that labor unions increase operating leverage by making wages sticky and layoffs costly (Chen et al. 2011), RTW adoption can lead to lower labor leverage, owing to weaker union strength in the RTW states.

By the end of our sample period, 26 states have introduced the RTW laws. Among these, 21 states adopted the RTW laws long before our sample period (i.e. most states adopted the RTW laws in the 1940s and 1950s) and five states adopted during our sample period including Oklahoma (adopted in 2001), Indiana (adopted in 2012), Michigan (adopted in 2013), Wisconsin (adopted in 2015), and West Virginia (adopted in 2016).[6] Specifically, we create an indicator variable, *PostRTW*, which takes a value of one for observations after the adoption of RTW laws in these five states (i.e. OK, IN, MI, WI, and WV). We use firms in the neighboring states of the five treated states as the control group. The neighboring states, within the subset of non-RTW states, include Colorado, Illinois, Kentucky, Maryland, Minnesota, Missouri, New Mexico, Ohio, and Pennsylvania. Then the following model is estimated using the neighboring states and the five treated states (Chava et al. 2019). We

[6] Kentucky (adopted in 2017) is excluded since our sample period ends in 2017.

further include state fixed effects and double-cluster standard errors at the state-year level (Petersen 2009).

$$CompAcct_t = \gamma_0 + \gamma_1 PostRTW_t + \gamma_2 Size_t + \gamma_3 DIVDUM_t + \gamma_4 MTB_t + \gamma_5 Leverage_t + \gamma_6 CFO5_t + \gamma_7 SALES5_t + \gamma_8 SalesGrowth_t + \gamma_9 Age_t + \gamma_{10} Big4_t + \gamma_{11} Analysts_t + \gamma_{12} Spread_t + \text{State Fixed Effects} + \epsilon \quad (7)$$

Panel A of Table 5 presents the results of estimating the model (7). We find that the coefficient on *PostRTW* is negative and significant, suggesting that firms provide less comparable financial statements after the RTW adoption. The results are consistent with our prediction that the adoption of RTW laws significantly weakens labor strength and managers respond to lower labor leverage by producing less comparable financial statements. As a robustness test, we exclude observations if they are within four years after the RTW adoption to address the concern that the estimation period of the comparability measure spanning the previous four years (i.e., 16 quarters) might hinder correct inferences (e.g. Hamm et al. 2018). The results are presented in Panel B. We still find that the coefficient on *PostRTW* is negative and significant, consistent with the results in Panel A. Overall, results in Table 5 support our hypothesis that a firm's labor leverage is positively associated with financial statement comparability and strengthen the inferences drawn in our study.

4.4. Cross-sectional analysis

Our previous findings indicate that firms subject to higher labor leverage are more likely to adopt more comparable financial statements. We expect that firms more vulnerable to the future negative economic shocks have even greater incentives to reduce operating risk arising from labor leverage. Consequently, these vulnerable firms are more likely to increase the financial statement comparability in order to facilitate managers to compare their performance with peers (Chen et al. 2018) and to make the labor adjustment decisions in a timely manner. Thus, we predict that the positive relation between labor leverage and

financial statement comparability is more pronounced for firms subject to more volatile economic condition, particularly, future negative economic shocks. To test this prediction, we employ three proxies for the riskiness and volatility in the business environment: stock return volatility, product market competition, and overall firm-level risk.

First, we use firm-level stock return volatility to proxy for the uncertainty in operating environment (e.g. Boutchkova et al. 2012; Chen et al. 2018) since higher stock return volatility indicates the higher likelihood of experiencing negative economic shocks in the future. Thus, managers of such firms have more incentives to adopt comparable financial statement when their labor leverage is higher. We measure stock return volatility as the annualized standard deviation of the firm's daily returns and create *RetVoldummy*, an indicator variable equal to one if a firm's stock return volatility is higher than the sample median and zero otherwise. Then, we interact this variable with our labor leverage measures. The positive coefficient on the interaction term will support our prediction that firms facing higher stock return volatility are more likely to adopt comparable financial statement in response to their higher labor leverage. Table 6 Panel A presents results on the effect of stock return volatility on the relation between labor leverage and financial statement comparability. Echoing our expectation, the coefficient on the interaction term between *Labor_Comp* and *RetVoldummy* is positive and significant at the 1% level. The results support our notion that firms subject to higher operating uncertainty have greater incentives to reduce the risk arising from labor leverage by increasing financial statement comparability.

As a second proxy, we use product market competition measure, measured as one minus Herfindahl-Hirschman index (HHI). The higher value of the inversed HHI index indicates more competitive environment within the industry, suggesting the higher likelihood of more volatile operating environment (Hamm et al. 2018). Similar with our first measure, we create *HHIdummy*, an indicator variable equal to one if a firm's product market

competition is higher than the sample median, and zero otherwise. Again, we interact this competition measure with *Labor_Comp*. A positive coefficient on the interaction term is expected to support our prediction that firms facing a higher level of competition have greater incentives to reduce the risk arising from labor leverage by increasing financial statement comparability. Results presented in Panel B of Table 6 show that the coefficient on the interaction term between *Labor_Comp* and *HHIdummy* is significantly positive, consistent with our prediction.

Lastly, we examine the effect of overall firm-level risk on the relation between labor leverage and comparability. Based on the textual analysis, the measure of overall firm-level risk is calculated as the frequency of synonyms for risk or uncertainty in the quarterly earnings conference call transcripts deflated by the length of the transcript (Hassan et al. 2019). Textual analysis allows this measure to cover various types of firm risk and market participants' views which are not captured in the return volatility measure. Consistent with our prior measures, we create a dummy variable, *Riskdummy*, based on the sample median to capture the risk in a firm's business environment. Then, we interact this *Riskdummy* with *Labor_Comp*. We expect to have a positive coefficient on the interaction term to support our prediction that managers of firms perceiving more risk are more likely to adopt comparable financial statement when labor leverage is higher. Results reported in Panel C show that the coefficient on the interaction term between *Riskdummy* and *Labor_Comp* is significantly positive, suggesting that managers' perceived risk strengthens the positive relation between labor leverage and comparability.

Overall, Table 6 shows that the positive relation between labor leverage and financial statement comparability is more pronounced if firms face higher uncertainty and more volatile environment.

5. Additional analysis

5.1. Financial statement comparability and the responsiveness of labor decision

To support our main argument underlying the effect of labor leverage on financial statement comparability, we further examine whether more comparable financial statement facilitates firms' timelier labor adjustments. If financial statement comparability helps managers better predict the firm's future performance along with underlying economic events and allows managers/rank-and-file employees to better understand the labor decision, managers' employment decision will become more sensitive to firm performance in order to reduce operating risk arising from labor leverage. In particular, we argue that managers with better understanding in future economic condition would reduce the labor forces in a timelier manner in response to the negative economic shocks to decrease operating risk related to labor leverage.

To test our argument, we follow Benmelech et al. (2015). We augment their model with a comparability measure and its interaction with a change in ROA, a proxy for firm performance.[7] Specifically, we estimate the following model (8):

$$\begin{aligned} Chg_{Emp_t} = {} & \gamma_0 + \gamma_1 Chg\_ROA_{t-1} + \gamma_2 CompAcct_{t-1} + \gamma_3 Chg\_ROA_{t-1} \times CompAcct_{t-1} \\ & + \gamma_4 Chg\_ROADEC_{t-1} + \gamma_5 Chg\_ROA_{t-1} \times Chg\_ROADEC_{t-1} \\ & + \gamma_5 CompAcct_{t-1} \times Chg\_ROADEC_{t-1} + \gamma_6 CompAcct_{t-1} \times Chg\_ROA_{t-1} \times \\ & Chg\_ROADEC_{t-1} + \sum_k \gamma_k Controls_k + Industry\ Fixed\ Effects \\ & + Year\ Fixed\ Effects + \epsilon, \end{aligned} \quad (8)$$

where *Chg_Emp* is the percentage change in the number of employees from year t-1 to t and it is obtained from Compustat (e.g., Jung et al. 2014; Benmelech et al. 2015; Falato and Liang 2016). *Chg_ROA* is change in return on assets, measured as income before extraordinary

[7] While we use the change in ROA to proxy for firm performance, there is a possibility that managers would not rely on the change in ROA when they evaluate their performance. Rather, managers may use ROA when they make the labor-related decision (e.g., Pinnuck and Lillis 2007). To address this concern, we employ ROA as an alternative measure of performance benchmark and find that the results based on ROA are qualitatively similar to those based on the change in ROA.

items divided by average total assets. *Chg_ROADEC* is a dummy variable for the decrease in ROA change and zero otherwise.

To consider the asymmetric relation between employee hiring and ROA change for ROA increases vs. ROA decreases, we additionally include *Chg_ROADEC* and interact it with comparability measure. We predict the coefficient γ_3 to be significantly positive, suggesting that comparability helps managers' timely employment decision in response to firm performance. We further expect the coefficient γ_6 to be significantly positive. If comparability facilitates managers' timely employment decision in bad times to a larger extent (i.e., ROA decreases) relative to good times (i.e., ROA increases), γ_6 should be significantly positive. We also include a set of control variables that have been suggested by prior studies to affect managers' employment decision (e.g. Benmelech et al. 2015; Benmelech et al. 2018). Specifically, Tobin's Q (*Q*) is included to control for the potential impact of firm's investment opportunities on employment decisions; Firm size (*Size*) is to control for the relation between firm size and employment decisions; Leverage (*Leverage*), asset maturity (*Maturity*), and credit rating dummy *(CreditRating*) are to control for the possible impact of capital structure on labor decisions. We further control for the level and growth of capital expenditures (*Capex* and *CapexGrowth*) to rule out the mechanical relation between labor decision and capital constraints. Industry and year fixed effects are included to control for variations in labor decisions across industries and over time, respectively. All regressions are estimated with heteroscedasticity robust standard errors that are clustered by firm. We also provide detailed variable definitions in Appendix 1.

Table 7 presents the regression results for the impact of financial statement comparability on the responsiveness of labor decisions to performance change. We first examine the relation between performance and employee hiring. Results in the first column show that the coefficient on ROA change is significantly positive, suggesting that managers

increase hiring when performance is improved. Results of estimating the model (8) are reported in the second column. We find that the coefficient on $CompAcct_{t-1} \times Chg\_ROA_{t-1}$ (γ_3) is not significant, while the coefficient on $CompAcct_{t-1} \times Chg\_ROA_{t-1} \times Chg\_ROADEC_{t-1}$ (γ_6) is significantly positive, indicating that comparability facilitates managers' firing decision when firm performance is poor.[8] The insignificant coefficient on $Chg\_ROA_{t-1} \times CompAcct_{t-1}$ (γ_3) implies that comparability does not play a significant role in managers' hiring decision when labor leverage doesn't impose much frictions on the firm's operation.

5.2. Financial statement comparability and corporate layoffs

To corroborate our findings that comparability increases the sensitivity of corporate employment to firm performance, we further examine whether comparability reduces the incidence of corporate large-scale layoffs and increases the incidence of fine-tuning employment decisions. If comparability enables timelier labor decisions, then the incidence of sluggish and untimely large-scale layoffs that is detrimental to firm value and firm reputation (Gunderson et al. 1997; Flanagan and O'Shaughnessy 2005) should decrease. In a similar vein, the incidence of drastic change in labor should decrease while the incidence of fine-tuning change in labor should increase. To validate our argument that comparability reduces the incidence of large-scale layoffs and decreases (increases) the incidence of large-scale change in labor decisions (fine-tuning labor decisions), we estimate the following models (9), (10), and (11):

$$Large-scale\ layoff_t = \gamma_0 + \gamma_1 CompAcct_{t-1} + \sum_k \gamma_k Controls_k + Industry\ Fixed\ Effects + Year\ Fixed\ Effects + \epsilon \quad (9),$$

$$Large-scale\ change\ in\ labor_t = \gamma_0 + \gamma_1 CompAcct_{t-1} + \sum_k \gamma_k Controls_k + Industry\ Fixed\ Effects + Year\ Fixed\ Effects + \epsilon \quad (10),$$

[8] As a robustness test, we also employ two alternative measures of comparability: *CompAcctAlt1* and *CompAcctAlt2* instead of *CompAcct* in the model (8). Results (untabulated) based on these alternative measures are generally consistent with those based on our primary comparability measure.

$$Micro-hiring\ management_t = \gamma_0 + \gamma_1 CompAcct_{t-1} + \sum_k \gamma_k Controls_k + Industry\ Fixed\ Effects + Year\ Fixed\ Effects + \epsilon \quad (11),$$

where *Large-scale layoff* is an indicator variable which equals one if a percentage change in the number of employees over the year is less than -10% and zero otherwise. *Large-scale change in labor* is an indicator variable equals one if the absolute value of a percentage change in the number of employees over year is greater than 10% and zero otherwise. *Micro-hiring management* is an indicator variable which equals one if the percentage change in the number of employees over year is between -1% and 1%.[9] We include control variables used in model (8). All regressions are estimated with heteroscedasticity robust standard errors that are clustered by firm. The detailed definitions on variables are presented in Appendix 1.

Table 8 reports the results of estimating the effect of comparability on the incidence of large-scale layoffs, large-scale change in labor decisions, and fine-tuning labor decisions. The coefficient on $CompAcct_{t-1}(\gamma_1)$ is significantly negative in the first column, suggesting that comparability lowers the incidence of large-scale layoffs. The coefficients on $CompAcct_{t-1}(\gamma_1)$ are significantly negative in the second column and positive in the third column, indicating that comparability significantly decreases the incidence of large-scale change in labor decisions and increases the incidence of fine-tuning labor decisions. Overall, the results suggest that financial statement comparability is beneficial in facilitating timelier adjustment of labor and reducing the likelihood of layoffs.

6. Conclusion

Prior literature documents financial statement comparability as a vital accounting attribute desired by the users and has provided evidence on the benefits of comparable financial statements for capital market participants. However, relatively little attention has

[9] Using alternative cutoff points for large-scale labor change definition (e.g., -15% or -20%) and fine-tuning definition (e.g., between -0.5% and 0.5%), we find qualitatively similar results to what we tabulate in Table 8.

been paid to the determinants of financial statement comparability and its effects on corporate decisions regarding labor. In this study, we explore the importance of financial statement comparability in corporate employment by examining labor-induced operating leverage as a determinant of financial statement comparability and how comparable financial statements are beneficial for managers' employment decisions.

Using a sample of 44,400 firm-year observations from 1992 to 2017, we find that labor leverage is positively associated with financial statement comparability, suggesting that firms with higher labor leverage tend to adopt more comparable financial statements. To address a concern on endogeneity issues, we utilize right-to-work (RTW) regulation change as an exogenous shock to examine the effect of labor leverage on financial statement comparability. We find that comparability is lower for firms in states adopting RTW regulations since RTW laws reduce employees' bargaining power and thus, operating risk due to labor leverage. Moreover, several cross-sectional tests show that the effect of labor leverage on financial statement comparability is stronger when firms are more likely to face future negative economic shocks. Taken together, these findings highlight that managers who have greater incentives to reduce operating risk owing to labor leverage tend to adopt more comparable financial statements. Lastly, we provide corroborating evidence that financial statement comparability increases the sensitivity of hiring to performance change and thus, reduces the likelihood of large-scale layoff. The results suggest that financial statement comparability facilitates more timely employment adjustments in response to the negative economic shocks, supporting our argument that financial statement comparability plays a significant role in mitigating the labor leverage.

Overall, our study contributes to the literature on financial statement comparability. By identifying labor leverage as a determinant of financial statement comparability, this paper advances our understanding in managers' incentives to adopt comparable financial

statements. Furthermore, we extend a stream of accounting research that explores the benefits of financial statement comparability by providing evidence that financial statement comparability shapes labor-related decisions in a timelier manner. Finally, we add to the literature regarding corporate labor by showing the influences of labor leverage on corporate financial reporting, providing new insights on the effects of labor-related costs.

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Appendix 1
Variable Definitions

Variables	Description
CompAcct	Median pairwise comparability for all peer firms in the same SIC2 industry as firm i during year t.
CompAcctAlt1	Mean pairwise comparability for all peer firms in the same SIC2 industry as firm i during year t.
CompAcctAlt2	Median pairwise comparability for all peer firms in the same SIC2 industry as firm i during year t, based on cash flow and net income. (Barth et al. 2012)
Labor_Comp	Composite measure of labor leverage, average ranks of the individual proxies (*LaborIntensity*, *UNION*, and *ELS*)
LaborIntensity	Number of employees divided by total assets
UNION	Firm-level union measure computed as a product of the industry-level unionization rate and firm-level labor intensity, following Hilary (2006)
ELS	Extended labor share, defined as labor expenses divided by value-added, following Donangelo et al. (2019). Specifically, $ELS\ it = \frac{LABEX\ it}{OIBDP\ it + \Delta INVFG\ it + LABEX\ it}$, where LABEX captures labor expenses, defined as the product of Compustat item EMP (number of employees) and the average annual labor cost per employee in the industry during the year.
Size	Natural logarithm of the total assets
DIVDUM	Indicator variable set to 1 if the firm issues dividend, otherwise zero
MTB	Market value of equity divided by book value of equity
Leverage	Sum of long-term and short-term debts divided by total assets
CFO5	Standard deviation in cash flows from operations divided by total assets over the prior five years
SALES5	Standard deviation in sales divided by total assets over the prior five years
SalesGrowth	Percentage change in firm sales
Age	Firm age
Big 4	Indicator variable set to 1 if firm's auditor is a Big 4 firm, otherwise zero
Analysts	Number of analysts following the firm
Spread	Absolute value of the annual average difference between daily bid and ask price, divided by closing price, and multiplied by 100
PostRTW	Indicator variable equals one for the observations after the RTW adoption, otherwise zero
RetVoldummy	Indicator variable equals one if the firm-level stock return volatility is above the sample median, otherwise zero
HHIdummy	Indicator variable equals one if the inverse of the Herfindahl-Hirschman index measured at the 3-digit SIC level is above the sample median, otherwise zero
Riskdummy	Indicator variable equals one if the overall firm-level risk is

	above the sample median, otherwise zero
Chg_Emp	Percentage change in the number of employees
Capex	Capital expenditure scaled by beginning of total assets
CapexGrowth	Percentage change in capital expenditure
Q	Tobin's Q, measured as market value of the firm over the replacement cost of its assets
Liquidity	Cash and cash equivalents divided by total assets
Maturity	Net property, plant, and equipment divided by annual depreciation expenses
CreditRating	Indicator variable equals one if the firm has a credit rating from Standard & Poor's, otherwise zero
ROA	Return on assets, measured as income before extraordinary items divided by average total assets
Chg_ROA	Change in return on assets
Chg_ROADEC	Indicator variable equals one if Chg_ROA is negative, otherwise zero
Chg_ROAINC	Indicator variable equals one if Chg_ROA is positive, otherwise zero
Large-scale layoff	Indicator variable equals one if the number of employees decreases greater than 10%, otherwise zero
Large-scale change in labor	Indicator variable equals one if the number of employees varies more than 10%, otherwise zero
Micro-hiring management	Indicator variable equals one if the number of employees varies less than 1%, otherwise zero

Table 1
Descriptive Statistics

Variable	N	Mean	SD	P25	P50	P75
CompAcct	44,400	-2.74	2.64	-3.16	-1.83	-1.20
CompAcctAlt1	44,400	-3.53	2.34	-4.06	-2.87	-2.14
CompAcctAlt2	37,712	-5.73	3.53	-6.76	-4.72	-3.48
Labor_Comp	44,400	6.16	2.13	4.67	6.33	8.00
LaborIntensity	44,400	0.01	0.01	0.00	0.00	0.01
UNION	44,400	0.07	0.12	0.01	0.03	0.08
ELS	44,400	0.53	0.32	0.29	0.63	0.80
Size	44,400	5.74	2.21	4.09	5.67	7.30
DIVDUM	44,400	0.36	0.48	0.00	0.00	1.00
MTB	44,400	2.93	5.58	1.22	2.03	3.46
Leverage	44,400	0.21	0.21	0.02	0.17	0.32
CFO5	44,400	0.08	0.09	0.03	0.05	0.09
SALES5	44,400	0.17	0.17	0.07	0.13	0.22
SalesGrowth	44,400	0.15	0.64	-0.04	0.07	0.19
AGE	44,400	21.25	14.38	10.00	16.00	29.00
Big 4	44,400	0.71	0.46	0.00	1.00	1.00
Analysts	44,400	7.60	8.42	1.00	5.00	12.00
Spread	44,400	1.80	2.32	0.18	0.96	2.46
PostRTW	44,400	0.01	0.09	0.00	0.00	0.00
RetVol	44,400	0.13	0.08	0.07	0.11	0.16
HHI	44,400	0.82	0.17	0.77	0.88	0.93
Risk	25,010	59.49	49.73	25.71	49.29	80.71

Notes: This table presents summary statistics of regression variables used in our analyses for the full sample. All variables are defined in the Appendix 1.

Table 2
Pearson Correlation Matrix

Variables	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
CompAcct																		
CompAcctAlt1	0.97*																	
CompAcctAlt2	0.35*	0.29*																
Labor_Comp	0.21*	0.20*	0.29*															
LaborIntensity	0.04*	0.04*	0.02*	0.52*														
UNION	0.07*	0.09*	0.11*	0.57*	0.61*													
ELS	0.22*	0.18*	0.35*	0.80*	0.31*	0.27*												
Size	0.22*	0.16*	0.23*	-0.12*	-0.22*	-0.15*	0.02*											
DIVDUM	0.24*	0.21*	0.31*	0.17*	-0.04*	0.08*	0.15*	0.44*										
MTB	0.01*	0.02*	-0.17*	-0.07*	-0.02*	-0.03*	-0.10*	0.14*	-0.01*									
Leverage	-0.08*	-0.06*	0.12*	0.05*	-0.04*	0.06*	0.04*	0.06*	0.05*	-0.08*								
CFO5	-0.25*	-0.21*	-0.61*	-0.21*	0.01	-0.04*	-0.29*	-0.27*	-0.27*	0.08*	-0.05*							
SALES5	-0.13*	-0.11*	-0.20*	0.06*	0.19*	0.12*	-0.03*	-0.26*	-0.17*	0.01*	-0.04*	0.30*						
SalesGrowth	-0.06*	-0.05*	-0.17*	-0.02*	0.04*	0.03*	-0.06*	-0.01	-0.09*	0.07*	-0.00	0.15*	0.04*					
Age	0.19*	0.16*	0.32*	0.09*	-0.08*	0.02*	0.11*	0.40*	0.50*	-0.03*	0.08*	-0.25*	-0.16*	-0.10*				
Big 4	0.052*	0.02*	0.07*	-0.07*	-0.09*	-0.10*	0.01	0.35*	0.10*	0.02*	0.04*	-0.09*	-0.10*	-0.01	0.09*			
Analysts	0.20*	0.16*	0.14*	-0.13*	-0.17*	-0.13*	-0.01	0.79*	0.25*	0.11*	0.05*	-0.20*	-0.18*	0.01	0.25*	0.26*		
Spread	-0.14*	-0.06*	-0.15*	0.14*	0.19*	0.19*	-0.03*	-0.60*	-0.24*	-0.07*	0.08*	0.18*	0.19*	-0.03*	-0.24*	-0.24*	-0.42*	
PostRTW	0.03*	0.02*	0.03*	-0.01	-0.01	-0.01	-0.01*	0.04*	0.05*	-0.01	0.02*	-0.01*	-0.01*	-0.01*	0.08*	-0.00	0.02*	-0.05*

Notes: Pearson correlations are shown below the diagonal. * denotes significance at the 5 percent level (using a two-tailed test). Variable definitions are provided in the Appendix 1.

Table 3
The relation between labor leverage and financial statement comparability

Panel A: Results based on labor intensity

	Dependent Variable = Comparability t		
Variables	*CompAcct*	*CompAcctAlt1*	*CompAcctAlt2*
LaborIntensity t	**8.047*** **	**4.342*** **	**14.904*** **
	(4.174)	**(2.598)**	**(5.837)**
Size t	0.026	-0.018	-0.010
	(0.654)	(-0.490)	(-0.403)
DIVDUM t	0.453***	0.275***	0.257***
	(7.211)	(4.947)	(4.132)
MTB t	0.001	0.004	-0.062***
	(0.221)	(1.456)	(-10.831)
Leverage t	-1.504***	-1.225***	0.393**
	(-10.488)	(-9.984)	(2.171)
CFO5 t	-3.608***	-2.467***	-27.111***
	(-5.613)	(-5.010)	(-35.764)
SALES5 t	-0.822***	-0.788***	-0.364*
	(-5.025)	(-5.796)	(-1.944)
SalesGrowth t	-0.093***	-0.057***	-0.453***
	(-3.815)	(-2.681)	(-11.035)
Age t	0.011***	0.010***	0.023***
	(4.043)	(3.998)	(11.791)
Big 4 t	-0.014	-0.005	0.134**
	(-0.316)	(-0.126)	(2.175)
Analysts t	0.035***	0.034***	-0.001
	(4.770)	(5.178)	(-0.149)
Spread t	-0.170***	-0.139***	-0.095***
	(-12.275)	(-11.462)	(-6.287)
Constant	-2.564***	-3.195***	-4.293***
	(-13.796)	(-19.914)	(-28.832)
Observations	44,400	44,400	37,712
Adjusted R-squared	0.217	0.257	0.474
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
Clustered	Firm	Firm	Firm

Panel B: Results based on union

	Dependent Variable = Comparability t		
Variables	*CompAcct*	*CompAcctAlt1*	*CompAcctAlt2*
UNION t	**0.585*** **	**0.341***	**1.265*** **
	(2.918)	**(1.949)**	**(5.676)**
Controls and intercept	Yes	Yes	Yes
Observations	44,400	44,400	37,712
Adjusted R-squared	0.216	0.257	0.474
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
Clustered	Firm	Firm	Firm

Panel C: Results based on labor share

	Dependent Variable = Comparability t		
Variables	*CompAcct*	*CompAcctAlt1*	*CompAcctAlt2*
ELS t	**1.089*** **	**0.662*** **	**2.299*** **
	(14.812)	**(10.907)**	**(23.425)**
Controls and intercept	Yes	Yes	Yes
Observations	44,400	44,400	37,712
Adjusted R-squared	0.230	0.264	0.506
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
Clustered	Firm	Firm	Firm

Panel D: Results based on the composite measure

	Dependent Variable = Comparability t		
Variables	*CompAcct*	*CompAcctAlt1*	*CompAcctAlt2*
Labor_Comp t	**0.171*** **	**0.103*** **	**0.324*** **
	(12.034)	**(8.683)**	**(18.307)**
Controls and intercept	Yes	Yes	Yes
Observations	44,400	44,400	37,712
Adjusted R-squared	0.227	0.262	0.494
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
Clustered	Firm	Firm	Firm

Notes: This table presents the regression results from estimating the model (6) using various proxies for labor leverage. Panels A, B, C, and D present the results of using labor intensity, union, labor share, and a composite measure of aforementioned three individual proxies as an independent variable, respectively. The sample consists of 44,400 firm-years for the period 1992−2017. All variables are defined in the Appendix 1. *t*-statistics are based on standard errors clustered by firm and presented below each coefficient. Coefficients of interest are bolded. ***, **, and * represent significance levels of 1, 5, and 10 percent, respectively, using two-tailed tests.

Table 4
Address the potential timing bias in the model

Panel A: Including lagged-comparability measure

	Dependent Variable = Comparability t		
Variables	*CompAcct*	*CompAcctAlt1*	*CompAcctAlt2*
Labor_Comp t	**0.122*** **	**0.079*** **	**0.142*** **
	(10.137)	**(7.821)**	**(10.620)**
Comparability t-3	0.461***	0.456***	0.475***
	(22.131)	(19.634)	(35.511)
Controls and intercept	Yes	Yes	Yes
Observations	29,742	29,742	24,805
Adjusted R-squared	0.399	0.431	0.622
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
Clustered	Firm	Firm	Firm

Panel B: Using only every fourth year of data

	Dependent Variable = Comparability t		
Variables	*CompAcct*	*CompAcctAlt1*	*CompAcctAlt2*
Labor_Comp t	**0.158*** **	**0.094*** **	**0.319*** **
	(9.693)	**(6.848)**	**(14.711)**
Controls and intercept	Yes	Yes	Yes
Observations	12,279	12,279	9,581
Adjusted R-squared	0.240	0.288	0.476
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
Clustered	Firm	Firm	Firm

Panel C: Measuring comparability at year t+4

	Dependent Variable = Comparability t+4		
Variables	*CompAcct*	*CompAcctAlt1*	*CompAcctAlt2*
Labor_Comp t	**0.248*** **	**0.161*** **	**0.439*** **
	(14.231)	**(11.034)**	**(18.015)**
Controls and intercept	Yes	Yes	Yes
Observations	27,619	27,619	26,035
Adjusted R-squared	0.204	0.258	0.408
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
Clustered	Firm	Firm	Firm

Notes: This table presents the regression results from estimating the model (6) after controlling for the potential timing bias in the model. Panel A, B, and C present the results of including lagged-comparability measure, only every fourth year of data, and using comparability measured at year t+4, respectively. All variables are defined in the Appendix 1. *t*-statistics are based on standard errors clustered by firm and presented below each coefficient. Coefficients of interest are bolded. ***, **, and * represent significance levels of 1, 5, and 10 percent, respectively, using two-tailed tests.

Table 5
Exogenous shock of Right-to-Work Law

Panel A: Full sample period

	Dependent Variable = Comparability t
Variables	*CompAcct*
PostRTW t	**-0.246****
	(-2.401)
Size t	0.297***
	(8.571)
DIVDUMt	1.071***
	(10.041)
MTBt	-0.004
	(-0.582)
Leverage t	-0.959***
	(-4.050)
CFO5 t	-3.116**
	(-2.504)
SALES5 t	-0.555*
	(-1.773)
SalesGrowth t	-0.078
	(-1.360)
Age t	-0.012***
	(-4.101)
Big 4 t	-0.145***
	(-3.115)
Analysts t	-0.020**
	(-2.830)
Spread t	0.026
	(0.868)
Constant	-3.533***
	(-12.342)
Observations	16,653
Adjusted R-squared	0.186
State FE	Yes
Clustered	State & Year

Panel B: Exclude observations within four years following the RTW adoption

	Dependent Variable = Comparability t
Variables	*CompAcct*
PostRTW t	**-0.274***
	(-1.795)
Controls and intercept	Yes
Observations	16,335
Adjusted R-squared	0.188
State FE	Yes
Clustered	State & Year

Notes: This table presents the regression results from estimating the model (7). Panel A presents the regression results based on full sample while panel B presents the results based on the sample excluding observations within four years from the RTW adoption to mitigate the concern that measurement of comparability spans previous four years. All variables are defined in the Appendix 1. *t*-statistics are based on standard errors double-clustered by state and year and presented below each coefficient. Coefficients of interest are bolded. ***, **, and * represent significance levels of 1, 5, and 10 percent, respectively, using two-tailed tests.

Table 6
Cross-sectional analysis

Panel A: The effect of stock return volatility

	Dependent Variable = Comparability t
Variables	*CompAcct*
Labor_Comp t	**0.085*** **
	(4.605)
RetVoldummy t	**-1.126*** **
	(-8.375)
Labor t * RetVoldummy t	**0.110*** **
	(5.788)
Controls and intercept	Yes
Observations	44,400
Adjusted R-squared	0.232
Industry FE	Yes
Year FE	Yes
Clustered	Firm

Panel B: The effect of product market competition

	Dependent Variable = Comparability t
Variables	*CompAcct*
Labor_Comp t	**0.151*** **
	(9.281)
HHIdummy t	**-0.376** **
	(-2.569)
Labor t * HHIdummy t	**0.038***
	(1.847)
Controls and intercept	Yes
Observations	44,400
Adjusted R-squared	0.227
Industry FE	Yes
Year FE	Yes
Clustered	Firm

Panel C: The effect of overall firm-level risk

	Dependent Variable = Comparability t
Variables	*CompAcct*
Labor_Comp t	**0.145*** **
	(5.706)
Riskdummy t	**-0.283** **
	(-2.009)
Labor t * Riskdummy t	**0.063*** **
	(2.578)
Controls and intercept	Yes
Observations	25,010
Adjusted R-squared	0.229
Industry FE	Yes
Year FE	Yes
Clustered	Firm

Notes: This table presents the regression results of cross-sectional analysis based on the uncertainty in operating environment. Panel A, B, and C presents the results of using stock return volatility, product market competition,

and overall firm-level risk as a proxy for the uncertainty in operating environment, respectively. All variables are defined in the Appendix 1. *t*-statistics are based on standard errors clustered by firm and presented below each coefficient. Coefficients of interest are bolded. ***, **, and * represent significance levels of 1, 5, and 10 percent, respectively, using two-tailed tests.

Table 7
The impact of financial statement comparability on the responsiveness of labor decision to firm performance

Variables	(1)	(2)
Chg_ROA t-1	0.061***	-0.017
	(9.37)	(-0.39)
CompAcct t-1		0.003**
		(2.42)
CompAcct t-1*Chg_ROA t-1		**-0.007**
		(-0.97)
Chg_ROADEC		-0.005
		(-1.25)
*Chg_ROA t-1*Chg_ROADEC*		0.135**
		(2.08)
*CompAcct t-1*Chg_ROADEC*		0.002
		(1.58)
CompAcct t-1*Chg_ROA t-1*Chg_ROADEC		**0.033*** **
		(3.16)
Capex t	0.865***	0.680***
	(33.65)	(17.33)
CapexGrowth t	0.025***	0.026***
	(21.52)	(12.67)
Q t-1	0.008***	0.014***
	(11.28)	(7.46)
Liquidity t-1	0.174***	0.125***
	(16.90)	(7.88)
Size t-1	0.013***	0.006***
	(18.73)	(4.92)
Leverage t-1	-0.021***	-0.019**
	(-3.89)	(-2.15)
Maturity t-1	0.000***	-0.000
	(5.10)	(-0.16)
CreditRating t-1	-0.048***	-0.022***
	(-15.14)	(-4.83)
ROA t-1	0.040***	0.135***
	(7.34)	(10.19)
Constant	-0.089***	-0.047***
	(-13.51)	(-4.66)
Observations	127,680	54,453
Adjusted R-squared	0.112	0.100
Industry Fixed Effects	Yes	Yes
Year Fixed Effects	Yes	Yes
Clustered	Firm	Firm

Notes: This table presents the regression results from estimating the model (8). All variables are defined in the Appendix 1. *t*-statistics are based on standard errors clustered by firm and presented below each coefficient. Coefficients of interest are bolded. ***, **, and * represent significance levels of 1, 5, and 10 percent, respectively, using two-tailed tests.

Table 8
The impact of financial statement comparability on the corporate layoffs

Variables	Dependent Variable = Large-scale layoff t	Large-scale change in labor t	Micro-hiring management t
CompAcct t-1	**-0.008*** **	**-0.008*** **	**0.002*** **
	(-8.57)	**(-8.61)**	**(4.21)**
Capex t	-0.473***	-0.472***	-0.129***
	(-15.79)	(-15.79)	(-6.37)
CapexGrowth t	-0.015***	-0.015***	0.002***
	(-13.15)	(-13.16)	(2.62)
Q t-1	-0.011***	-0.011***	0.001
	(-7.94)	(-7.94)	(0.70)
Liquidity t-1	-0.002	-0.002	-0.048***
	(-0.14)	(-0.12)	(-4.66)
Size t-1	-0.022***	-0.022***	-0.003***
	(-14.67)	(-14.74)	(-2.84)
Leverage t-1	0.039***	0.039***	-0.007
	(3.50)	(3.51)	(-0.90)
Maturity t-1	0.000***	0.000***	0.000***
	(2.59)	(2.59)	(2.92)
CreditRating t-1	0.013**	0.013**	0.022***
	(2.09)	(2.07)	(4.67)
ROA t-1	-0.262***	-0.262***	0.034***
	(-17.21)	(-17.20)	(5.00)
Constant	0.323***	0.324***	0.128***
	(28.04)	(28.08)	(14.86)
Observations	56,388	56,388	56,388
Adjusted R-squared	0.107	0.107	0.016
Industry Fixed Effect	Yes	Yes	Yes
Year Fixed Effect	Yes	Yes	Yes
Clustered	Firm	Firm	Firm

Notes: This table presents the regression results from estimating the model (9), (10), and (11). All variables are defined in the Appendix 1. *t*-statistics are based on standard errors clustered by firm and presented below each coefficient. Coefficients of interest are bolded. ***, **, and * represent significance levels of 1, 5, and 10 percent, respectively, using two-tailed tests.