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Alternative Work Arrangements and Cost of Equity: Evidence from a Quasi-Natural Experiment

Atsushi Chino*

Abstract

I examine whether firms' use of alternative work arrangements, particularly temporary agency workers, affects their cost of equity. Exploiting a major labor-market deregulation in Japan that induced manufacturing firms to increase their employment of temporary agency workers, I show that the cost of equity decreased in manufacturing firms, relative to nonmanufacturing firms, after the deregulation. Further analysis using variations within manufacturing firms provides corroborating evidence. The rigidity in labor expenses and the cost of debt also decreased in manufacturing firms. Overall, alternative work arrangements increase the flexibility in labor costs, leading to lower operating leverage and cost of capital.

I. Introduction

Alternative work arrangements, or nonregular workers, such as temporary agency workers or fixed-term contract workers, have become increasingly prevalent in many countries. The *OECD Employment Outlook* (Organization for Economic Cooperation and Development (OECD (2014), Figure 4.1, p. 150)) shows that the incidence of nonregular employment increased in many countries over the 5-year period around the 2008 financial crisis. Katz and Krueger (2016) also document a sharp increase in alternative work arrangements in the U.S. labor

*Chino, achino@nagasaki-u.ac.jp, Nagasaki University Department of Economics. I am especially grateful to Xiaoji Lin (the referee), whose comments substantially improved the article. I also appreciate helpful comments from David Denis, Yuichi Fukuta, Takato Hiraki (discussant), Paul Malatesta (the editor), Dev Mishra (discussant), Hiroshi Morita, Hidenori Takahashi, Mengying Wang (discussant), and Kazuo Yamada; seminar participants at the Nagoya University, the Ritsumeikan University, and the Yokohama National University; and conference participants at the 2016 Nippon Finance Association Meeting, the 2018 Asian Finance Association Meeting, and the 2018 Financial Management Association Meeting. I acknowledge financial support from the Japan Society for the Promotion of Science (JSPS KAKENHI Grant JP17K03821). All errors are my own.