

## State Ownership and Labor Cost Stickiness: The Role of Free Cash Flows<sup>1</sup>

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### INTRODUCTION

This study examines the effect of free cash flows on the relationship between government ownership and labor cost stickiness, offering evidence of how non-economic considerations and socio-political goals influence cost behavior. Cost stickiness where costs rise more with increased activity than they fall with decreased activity is a critical factor in managerial decision-making and firm performance. Identifying its determinants is thus essential.

Ownership structures create varying incentives for cost management. The type of ownership influences how benefits from cost-control activities are distributed, leading to distinct cost behaviors across firms. In state-owned enterprises, politicians may leverage their control to impose higher labor costs such as increased wages or sustained employment levels to secure political support. These socio-political objectives can conflict with shareholder interests, potentially undermining financial performance or value maximization.

Unlike private firms, state-owned companies pursue broader social goals tied to socio-political interests, often resulting in cost stickiness. Government ownership may shape managerial decisions and cost behavior due to concentrated ownership dynamics. This research investigates whether state ownership increases labor cost stickiness and whether free cash flows moderate this relationship. It is hypothesized that labor cost stickiness is greater under government ownership than non-government ownership and that higher free cash flows amplify the effect of government ownership on cost stickiness.

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## MATERIALS AND METHODS

The study's statistical population consists of companies listed on the Iran Stock Exchange from 2013 to 2022. Companies in the investment, insurance, banking, credit, holding, and leasing sectors were excluded due to their unique operational nature. Only firms continuously active during the study period with fiscal years ending in March were included. The final sample comprises 151 companies, yielding 1,498 firm-year observations.

## RESULTS AND DISCUSSION

The findings indicate that state ownership positively affects labor cost stickiness, with free cash flows reinforcing this relationship. This suggests that government-owned firms, driven by socio-political interests, prioritize broader social goals over cost adjustment, particularly when sales decline. Managers of state-owned companies appear reluctant to reduce labor costs during downturns. Additionally, higher free cash flows increase public scrutiny and government intervention, amplifying socio-political pressures and further entrenching labor cost stickiness in large state enterprises.

## CONCLUSION

Ownership structures influence cost stickiness differently due to varying objectives and oversight mechanisms. In state-owned firms, cost behavior and performance are shaped by governance factors and socio-political considerations. When production demand rises, firms hire more employees; however, because firing costs typically exceed hiring costs, managers are less inclined to reduce staff during demand declines than to hire during upturns. This asymmetry contributes to cost stickiness.

Based on the findings, reducing cost stickiness in state-owned firms could involve lowering government ownership through privatization, alongside considering factors like free cash flows, to enhance performance. This study adopts the resource adjustment cost perspective, factoring in non-economic considerations. Future research could explore managerial traits (e.g., overconfidence) and incentives (e.g., earnings management or compensation) as drivers of labor cost stickiness, with industry type as a potential moderating variable.

A key contribution of this research is its examination of state ownership's effect on labor cost stickiness and the moderating role of free cash flows in the context of a developing economy like Iran, enriching the theoretical literature on cost behavior in emerging markets.

**Keywords:** State Ownership, Labor Cost Stickiness, Free Cash Flow.

**JEL Classification:** M49, M41, N25, G14.

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