

The Cost (and Unbenefit) of Conscious Capitalism*

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Abstract

This paper examines the costs and benefits of ‘stakeholder governance’ for shareholders and other stakeholders by using the adoption of constituency statutes as a quasi-exogenous shock to corporate governance. Constituency statutes permit board members to consider all stakeholder interests, relaxing fiduciary duty to only shareholders. Using a sample of U.S. publicly traded firms (1981-2010) and employing a difference-in-difference methodology, we find that the discretionary adoption of ‘stakeholder governance’ leads to managerial entrenchment and a reduction in institutional ownership and shareholder wealth with little to no ‘trade-off’ benefits to other stakeholders. As states adopted constituency statutes, signs of managerial entrenchment increased (proxied by significant declines in earnings transparency and jumps in CEO and Director compensation) as did harm to shareholder wealth and to governance through institutional ownership. At the same time, we do not observe potential ‘trade-off’ benefits to the non-shareholder stakeholders these statutes were intended to help; we find that labor, customers, and creditors only marginally benefited (if at all) from the introduction of these statutes. These results are robust to battery of checks including the biasedness in staggered DiD estimator.

Keywords Conscious Capitalism • Stakeholder Governance • Managerial Accountability • Corporate Transparency • Constituency Statutes

JEL Classification G30 • L51

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1 INTRODUCTION

The recent announcement by the Business Roundtable that “corporate leaders should take into account ‘all stakeholders’ in business decision making” followed by the near-immediate retort by the Council of Institutional Investors that “accountability to everyone means accountability to no one” (Tett 2019) has reinvigorated the decades’ old debate on the ‘objective of the firm.’ Over decades, scholars across disciplines have proposed and discussed myriad ‘objectives,’ including (but not limited to) shareholder value maximization (Berle 1932; Friedman 1970; Jensen and Meckling 1976), stakeholder theory (Dodd Jr. 1932; Freeman 1984), long-term firm value maximization (Jensen 2002), shareholder welfare maximization (Hart and Zingales 2017), and shareholder wealth maximization with stakeholder interests (Bhagat and Hubbard 2020). While each of these objectives informs what should be prioritized by decision-makers and, thus, how corporate governance should unfold, the first two represent canonical extremes to each other, while the remainder constitutes modified versions of the first two. At one extreme (shareholder value maximization), directors and managers hold a fiduciary duty solely to protect shareholder interests (hereafter, ‘shareholder primacy’, Stout 2002). At the other extreme (stakeholder theory), those same decision-makers are expected to take into consideration the impact of their decisions on various constituencies – shareholders, creditors, clients, employees and others; this view has gained traction in the form of different names – ‘stakeholder governance’, ‘stakeholder theory’, or ‘conscious capitalism’ (Mackey and Sisodia 2013; The Economist 2019).

In this paper, we examine how shareholders and other stakeholders were impacted by a quasi-exogenous shock to firm governance that began to emerge on a state-by-state basis across the United States; so-called ‘constituency statutes’ began allowing, but not requiring, directors to take into consideration a broader group of stakeholders in their decision-making outside of just shareholders (Orts 1992-1993). The introduction of constituency statutes created an important shift in responsibilities for directors and managers as corporate decision-makers. Whereas under shareholder primacy, both held a fiduciary ‘duty’ to prioritize the interest of just one stakeholder—shareholders—under constituency statutes, directors (directly) and managers (indirectly) now hold a ‘right’ to prioritize some stakeholder interests over others. Despite

arguments that accountability to multiple stakeholders would harm both shareholders and the firm itself (Macey 1991; Bebchuk and Tallarita 2020), the consequences of the adoption of these statutes have been surprising. With few exceptions (e.g., Alexander et al. 1997), constituency statutes have been shown to enhance value to shareholders in many ways—e.g., via smaller loan spreads (Gao et al. 2020), increased Tobin's Q (Cremers et al. 2019), and increased innovation (Flammer and Kacperczyk 2015), while at the same time benefiting other stakeholders—e.g., via greater board representation (Luoma and Goodstein 1999) and increased corporate social responsibility (CSR) activity (Flammer 2015). Given that constituency statutes open the door to trade-offs between different constituencies, we feel that there is value in examining possible tradeoffs happening at the same point in time, rather than focusing on the impact of the statutes on any particular constituent viewed alone. By examining such tradeoffs across constituencies akin to a more 'zero-sum game' situation, we can assess which constituents suffered and which benefited from the change in governance effected by the introduction of a constituency statute. Our approach also verifies whether there is a possibility of a Pareto optimal solution, wherein shareholders remain unaffected but other stakeholders benefitted.

From a theoretical perspective, Macgill et al. (2015), Allen et al. (2021), and Karpoff (2021) have looked into this matter. The Macgill et al. (2015) model shows that there is a possibility of 'stakeholder equilibrium' based on certain pre-conditions such as the possibility of negative externalities and that these externalities are not resolved by the government or the regulator. However, the model is based only on one firm. The Allen et al. (2021) model compares stakeholder firms versus shareholder firms and shows that production cost uncertainty similarly affects these different forms of organizations. Nevertheless, during product demand uncertainty, stakeholders' firms reduce prices to support all stakeholders, increasing competition and negatively affecting shareholders' value. Lastly, the Karpoff (2021) model supports the shareholder value maximization objective with allowance for managers to deviate from this objective when the impact of negative externalities on other stakeholders is large. The paper also suggests that to constrain managerial opportunism, such deviations should be defended with a new type of double bottom line reporting, which augments traditional financial reporting with a statement of the social benefits of any

deviations from shareholder value maximization. In that sense, our paper follows Karpoff (2021) as we examine, empirically, the cost and benefits of stakeholder governance to shareholders and other stakeholders, and also, how it impacts agency issues.

One cannot ignore the fundamental claim that drove so many corporate and legal scholars' concerns about these statutes—that trade-offs *must exist* between the various constituencies vying for the attention and resources of the directors and managers (Macey 1991; Rogers 1994). Macey (1991: 32) warned that “the primary beneficiaries of non-shareholder constituency statutes are incumbent managers, who can justify virtually any decision they make on the grounds that it benefits some constituency of the firm.” Jensen (2002: 242) further warned that by “expanding the power of managers in this unproductive way, stakeholder theory, therefore, increases agency costs in the economic system.” In short, both warned that accountability to multiple stakeholders is the equivalent of accountability to no one—an agency theory-centric view of managers that has come under fire recently as a mischaracterization of managerial motivation. More conscious capitalism views of managers portray them as individuals seeking meaning in their corporate activities (Marquis 2020). “Conscious businesses are galvanized by higher purposes that serve, align and integrate the interests of all their major stakeholders” (Mackey and Sisodia 2013: 1). Even *The Economist* (2019) has joined the conversation on what responsibilities firms have to help society confront political power disparities and deeply entrenched societal-wide problems, such as wealth inequality and climate change.

The purpose of this paper is thus to explore what cost versus benefit trade-off may have emerged by giving directors (directly) and managers (indirectly) the right to balance the interest of myriad constituencies rather than the sole duty to prioritize the interests of just one constituency—shareholders. We examine whether fears of managerial entrenchment were justified (measured by earnings management and CEO and director compensation) and whether other stakeholder benefits manifested from the shift from ‘duty’ to ‘right’ create trade-offs between them. Examination of potential benefits to labor (measured as labor expense, unionization percentage, labor productivity and SG&A-to-sales), benefits to creditors (measured as interest coverage ratio), benefits to customers (measured as advertising expenditure), and

benefits to shareholders (measured as price-to-earnings growth and institutional investors holdings) all suggest that stakeholders broadly did not benefit from the introduction of constituency statutes (as the drafters may have intended). We also conduct a battery of robustness checks, including a two-stage model, nearest neighbor propensity score matching, subsample analyses and temporal dynamics analyses. All combined, we find evidence that constituency statutes exacerbated managerial entrenchment, whose negative impact was not offset meaningfully through benefits to labor, customers, debtors and shareholders.

To establish the robustness of our findings, we perform a series of additional checks. First, we conduct additional robustness checks (see section 6.4) to address the recent literature in finance (e.g., Karpoff and Wittry 2018) and law (e.g., Catan and Kahan 2016) regarding how anti-takeover laws may not be completely exogenous (Adams and Matheson 2000; Cremers et al. 2019). Second, we show that the results are immune to biasedness in staggered difference-in-difference (DiD) estimation (see section 6.5), a potential pitfall that has been raised in recent econometrics literature regarding staggered DiD design with a multiple time-period, multiple group setup (Callaway and Sant'Anna 2020; Baker et al. 2021; Goodman-Bacon 2021). Lastly, to provide a more thorough test for CS adoption on shareholder wealth, following past studies, we conduct an event study using the 623 unique events and find that 3-day and 11-day cumulative abnormal returns are negative (see section 6.6). These results confirm that the CS adoption affected shareholder wealth negatively, which provides evidence of managerial entrenchment. Our main findings echo Bhagat and Hubbard (2020) arguments that without addressing the theoretical and practical challenges of stakeholder governance, a lack of managerial accountability may become a problem.

The remainder of our study proceeds as follows. Section 2 lays out the institutional details on constituency statutes and their adoption. Section 3 explains the hypotheses and their development. Section 4 provides the details on data. Section 5 describes the empirical strategy. Section 6 discusses the results and Section 7 concludes.

2 INSTITUTIONAL BACKGROUND

Decades of literature in finance and accounting confirm that investors—as residual claimants—demand firm-specific information for decision-making. A firm that provides adequate information to investors is categorized as more transparent (or as less opaque). Irrespective of the channel, information flow depends, in large part, on the strength of the firm’s corporate governance (Bushman et al. 2004; Hermalin and Weisbach 2007), which encompasses a complex system of contractual and legislated fiduciary duties that require directors and managers to make decisions consistent with those duties (Adams and Matheson 2000). Traditionally, directors and managers have viewed their duty as prioritizing the interests of shareholders first and foremost when making corporate decisions (Jensen and Meckling 1976; Myers 1977), a perspective known as ‘shareholder primacy’ (Stout 2002).

Advocates of shareholder primacy (Friedman 1970; Jensen and Meckling 1976; Jensen 2002) justify their view by theorizing that incomplete contracting is more severe for shareholders than for other constituents. This is because shareholders face many more state contingencies compared to other stakeholders (Macey 1991). State contingencies for non-shareholder constituencies can be contracted one way or the other, for example, through employment contracts, collective bargaining agreements, bond indentures and covenants, or similar methods. For their part, firms are rewarded for delivering transparency by achieving lower cost of capital (Diamond and Verrecchia 1991; Healy and Palepu 1993; Barth et al. 2013), narrower spreads in bond markets (Bessembinder and Maxwell 2008), less sensitivity to noise driven by investor moods (Bushee and Friedman 2016) and being more innovative (Zhong 2018).

Over the decades, numerous voices have arisen in opposition to the premise that the primary focus of firms should be the maximization of shareholder value to the exclusion of other stakeholders. In *Harvard Law Review* in 1932, Dodd (1932) argued in favor of the notion that firms should consider the interests of all stakeholders, not just shareholders. Later, Freeman (1984) also argued that corporations operate more efficiently and effectively when management is able to consider the interests of other stakeholders when setting corporate policy and making corporate decisions. Freeman theorized that if a corporation devotes resources to the welfare of employees (as opposed to a shareholder dividend, for example), then ultimately, the corporation as a whole would benefit through an increase in stakeholder goodwill and productivity.

Still, others have argued that corporate responsibility extends beyond just efficiency considerations to include nurturing an environment of human thriving and helping to redress structural and societal inequities more broadly (Davis et al. 1997; Diener and Seligman 2004; Jackson and Nelson 2004; Hart 2005). There is growing empirical evidence that prioritizing stakeholders beyond shareholders may actually benefit firms, including attracting new customers and strengthening relations with existing ones (Cen et al. 2015), and increasing firm value or returns (Cremers et al. 2019).

This debate between prioritizing shareholders versus the broader consideration of myriad stakeholders became heightened during the hostile takeover wave of the 1980s. Although takeover deals routinely benefited and appealed to shareholders, they typically imposed significant costs on creditors, employees, customers, suppliers, and communities and, accordingly, catalyzed consideration of whether the fiduciary duties of directors and managers under the law should be extended to a broader group of stakeholders. This debate ultimately led to the adoption of the first constituency statute (Karpoff and Wittry 2018), which made clear that boards of directors may make decisions that account for the needs of stakeholders outside of just shareholders. The key words here are “may make decisions,” which provide the discretionary right to management to deviate from performing its traditional fiduciary duty toward shareholders to take into consideration other non-shareholder constituents (e.g., employees, customers and creditors). The reach of these statutes extended well beyond takeovers to broader corporate decision-making in general (Bainbridge 1992; Elhauge 2005). Ohio was the first to enact a constituency statute in 1984, and in the decades since has been followed by over 30 other states (see Figure 1).

[Insert Figure 1 About Here]

Given the non-obligatory nature of constituency statutes, one may question why some corporate decision-makers may choose to consider stakeholders’ interests, while others may not. The literature suggests there are, at a minimum, four possible answers. First, decision-makers may believe that they (and their company) have a moral responsibility to consider broader stakeholder interests (Pirson and Lawrence 2010; Strine Jr 2014; Tett 2019). Second, a decision-maker may benefit in the labor market from having fostered a reputation for having good relationships with various stakeholder groups (Borghesi et al. 2014).

Third, decision-makers could feel social pressure to take action, driven by either their peers (Business Roundtable 2019) or by social movements (King and Soule 2007). Fourth, the risk preferences of insider corporate decision-makers are more aligned with those of other stakeholders with lower risk preferences than shareholders, owing to the fact that their economic interests in the firm extend beyond a pure equity holding (Wang and Dewhirst 1992; Johnson and Greening 1999).

As pointed out by Orts (1992-1993) and Springer (1999), the core premise underlying constituency statutes is that directors should be empowered to set policy and make decisions based on a consideration of various stakeholders' interests, and not just those of shareholders. Bainbridge (1992) and others contended that this broader focus should not harm shareholders and that the firm as a whole—and thus all stakeholders—would benefit in the long run. So while legal scholars (Mitchell 1992; von Stange 1994) warned that constituency statutes threatened decades of corporate law by changing the established principle that directors owe a primary fiduciary duty to shareholders, Cremers et al. (2019) found significant increases in shareholder value following the introduction of these statutes. And while Rogers (1994) worried that board members and managers might further their own interests with the discretion constituency statutes afford, Gao et al. (2020) argued that the stakeholder orientation facilitated by those same statutes mitigates conflicts of interest between shareholders (as residual claimants) and non-shareholder stakeholders (as fixed claimants), reducing agency cost of debt. There are clear indications that some degree of agency is affected by the introduction of constituency statutes. Importantly, while constituency statutes explicitly only articulate the rights of directors, we argue that managers inevitably will also be influenced by this explicit articulation of the freedom to consider non-shareholder interests in law. The introduction of constituency statutes has been linked with increased innovation outcomes (Flammer and Kacperczyk 2015) and increased corporate social responsibility (CSR) activity (Flammer 2015), things for which managers more so than directors would be responsible. Thus, we argue that the passage of these constituency statutes at the state level opens the door for corporate decision-makers—including both directors and managers—to set aside shareholder concerns while not providing expected benefits to other stakeholders.

3 HYPOTHESES DEVELOPMENT

The governance of firms is constituted through both exogenous and endogenous mechanisms. On the exogenous front, changes in laws (including common law judgments through the courts) and their implementation through the rule-writing and monitoring process in government agencies impact the responsibilities of managers and their accountability regime (Leuz 2007; Zhang 2007). In addition, changes in accounting rules and/or reporting requirements on public exchanges also impact the governance regime (Berger and Hann 2003; Choudhary et al. 2009). On the endogenous front, the board of directors might institute various changes in governance within the firm's walls. These may include reporting requirements to the board itself (Bloch et al. 2012), the modification of incentives and compensation schemes (Cardinaels and Yin 2015), and the decision to change the firm's auditor (Brown and Knechel 2016), among others. These endogenous changes traditionally have been intended to constrain managerial discretion and align activity with shareholder interests; it is the implementation of these various structures, incentives, and processes as well as the monitoring to ensure compliance that constitutes agency costs. Importantly for this study, constituency statutes alter both factors, first (through a quasi-exogenous change in governance) by allowing managerial discretion to depart from a duty to shareholder concerns, and second (through an endogenous change in governance) by altering the monitoring of managers by the board.

Three complementary rationales predict that transparency should go down in the face of statutes that allow for the consideration of various stakeholder demands. First, Jensen and Meckling (1976: 308) argued, "it is generally impossible for the principal or the agent at zero cost to ensure that the agent will make optimal decisions from the principal's viewpoint" and "there will be some divergence between the agent's decisions and those decisions which would maximize the welfare of the principal." There is a reason why it is larger firms with more resources that institute stricter disclosure rules rather than smaller firms (Hermalin and Weisbach 2012); delivering high quality information to shareholders is not costless. As various stakeholders make demands on finite resources, fewer resources are available to deliver high quality disclosures to shareholders.

Second, substantial research shows that various professionals, ranging from IRS agents to CEOs to directors, have a finite capacity to take in information and process it fully. Bozanic et al. (2017) have shown how changes in SEC disclosure requirements alter what IRS agents pay attention to with respect to corporate taxation. Analyzing hundreds of board meeting transcripts, Tuggle et al. (2010) found that board members selectively allocate attention to their monitoring function in ways that are contextually dependent. Renjie and Verwijmeren (2019) likewise found that board monitoring intensity goes down when directors become distracted by exogenous shocks in unrelated industries in which they hold other directorships. Drake et al. (2016) and Aboody et al. (2010) made similar attention-based arguments for investors, while Cole and Chandler (2019) did so for CEOs, journalists, and corporate customers.

We contend that it is much easier to make decisions if one is only accountable to one constituency—i.e., shareholders via the traditional governance structure of shareholder primacy. As budget, time, and attention are shifted to multiple constituencies that often hold conflicting demands on directors and managers, however, decision-making becomes more difficult. Not only is taking in sufficient information to make the optimal decision now even more challenging, but it also becomes more difficult for decision-makers to fully defend their decisions when demanded of them because resources are now split across so many constituents. We theorize that this combination of limited resources (e.g., budget, time, attention) and fear of being held accountable for these ever-changing standards will lead to the decision to release less information to the market in the face of legislation that allows consideration of numerous constituencies. There is evidence that managers withhold information when calls for accountability might be high (Amir et al. 2018). In short, the less transparent a firm is, the lower the ability of shareholders to demand accountability or even ‘fair treatment’ in the allocation of finite resources.

Third, it is anticipated that an entrenchment mentality among managers will increase in the face of constituency statutes. Not only will monitoring by the board be compromised in the face of various stakeholder demands, but managers also will come to understand that nearly every decision they make—short of outright fraud—can be justified as addressing the priorities of some stakeholder group (Bhagat and Hubbard 2020). Jensen and Meckling (1976: 311) provided a congruent rationale when they referred to the

firm as a “legal fiction which serves as a focus for a complex process in which the conflicting objectives of individuals (some of whom may ‘represent’ other organizations) are brought into equilibrium within a framework of contractual relations” (emphasis added). Entrenchment mentality has long been connected to lower informational quality to investors (Bertrand and Mullainathan 2003; Francis et al. 2005).

Relying on these logics, we argue that including all stakeholders in the firm framework will squeeze the resources (efforts or time) of the board of directors to monitor managers, aggravating agency problems along the way. We also have provided a theoretical model in Appendix B, showing how the adoption of stakeholder governance would lead to managerial opportunism. Therefore, we hypothesize that this will reduce the firm’s accountability towards shareholders in discernable ways (Macey 1991; Romano 1993), particularly through the quality of information disclosure and the ability to extract greater compensation from the firm than would otherwise be accommodated under a ‘duty’ regime.

H1a. Shareholders of firms incorporated in a state that adopts a constituency statute will experience lower earnings transparency compared to firms incorporated elsewhere.

H1b. Managers and directors of firms incorporated in a state that adopts a constituency statute will experience higher compensation compared to firms incorporated elsewhere.

The passage of constituency statutes allows directors and managers to accommodate the interests of all stakeholders, not just shareholders, in their decision-making. But whether decision-makers accommodate those myriad interests remains a function of their incentives to do so. When one has a ‘duty’ to act in a particular way, then a failure to fulfill that duty garners sanctions for that failure. The threat of sanctions, therefore, creates an incentive to avoid the sanctions, and thus fulfill the duty. Under shareholder primacy, Stout (2002) argues that shareholders hold no right to demand access to private deliberations of managers or directors, nor the right to review privately held corporate information (such as the corporate tax returns filed with the Internal Revenue Service, as opposed to the 10-K and 10-Q financial disclosures that are made public under GAAP accounting standards). Because of this lack of access, if shareholders do

not agree with a corporate decision, their only real recourse is to sell their equity holdings in the firm (e.g., Sloving et al. 1995; Battalio et al. 2012). Under a ‘duty’ regime to shareholders, the threat of sanctions is the threat of equity sell-off, which makes the firm an easier target for hostile takeovers and may lead both directors (Yermack 2004) and managers (Wowak et al. 2011) to lose their positions through a settling up process (Fama 1980; Greve et al. 2010).

In contrast with ‘duty,’ when one has a ‘right’ to act in a particular way, a failure to exercise that right is not as immediately sanctionable. Observers expecting the exercise of said right may demand an explanation for why it was not exercised, but that requires access to the decision-maker as well as effort and time. If shareholders have no right to access under the ‘duty’ regime of shareholder primacy (Stout 2002), then stakeholders should have even fewer rights to access under the ‘right’ regime of constituency statutes. What is worse from an accountability perspective of stakeholders, because constituency statutes allow for the accommodation of any number of different constituencies, decision-makers can easily justify their decisions as balancing various constituencies, which is why the inquiring stakeholder group (e.g., employees, customers, debtholders, etc.) did not necessarily benefit from the exercise of that right.

Bebchuk and Tallatita (2020) argue that stakeholder orientation creates illusory hope that those afforded the right to protect stakeholders would choose to execute those rights. And there is empirical evidence that corporate decision-makers do not avail themselves of those rights when afforded them. In a study of corporate decision-making under constituency statutes, Bebchuk et al. (2020) analyzed over a hundred cases of the sale of firms to private equity buyers. They found that under constituency statutes corporate decision-makers did not incorporate any substantial stakeholder protections (Bebchuk et al. 2020). It is for this reason that we hypothesize that under a ‘rights’ regime afforded by constituency statutes, not only will non-shareholder stakeholders not benefit from the statutes, but that shareholders (as just one of many stakeholders) will also be worse off than they would be under a ‘duty’ regime.

H2a. Non-shareholder stakeholders of firms incorporated in a state that adopts a constituency statute will not experience positive impacts from firm actions compared to firms incorporated elsewhere.

H2b. Shareholders of firms incorporated in a state that adopts a constituency statute will experience negative impacts from firm actions compared to firms incorporated elsewhere.

Over the years, large block institutional investors have become an important part of the corporate governance apparatus, including actively monitoring firm management and engaging in influence attempts on managerial and director decision-making (Crutchley et al. 1998). The impact of institutional investors flexing their muscles has had a profound effect, especially when other shareholders are widely dispersed, impeding their ability to act collectively (Anson et al. 2003). As one example, nearly three-fourths of firms that are targeted by the massive California Public Employees' Retirement System (CalPERS) have adopted changes proposed by the institutional investor or have made changes resulting from settlements with it (Smith 1996).

Research shows that the proportion of equity holdings by institutional investors is positively related to the probability of a firm being targeted for shareholder activism by those investors (Smith 1996). Except in the case of momentum traders and those with high turnover, when institutional ownership is high, managers are less likely to engage in short-term thinking, such as cutting R&D in the face of earnings declines (Bushee 1998).

However, because constituency statutes allow management and directors to avoid addressing shareholder concerns by using other stakeholders' concerns as camouflage, we theorize that the ability of institutional investors to demand (and receive) compliance with their demands may be thwarted. If stakeholders have a lower ability to pursue accountability under the 'rights' regime created by constituency statutes than shareholders have under the 'duty' regime of shareholder primacy (Stout 2002), then those who traditionally could influence managerial decision-making by holding large blocks of shares—i.e., institutional investors—should also see their rights to demand accountability diminished. We anticipate that this lack of ability to influence decision-making under constituency statutes will drive institutional investors away from firms incorporated in states that adopt those statutes.

H3. Institutional investors with holdings in firms incorporated in a state that adopts a constituency statute will reduce their ownership stakes compared to firms incorporated elsewhere.

4 DATA AND METHODOLOGY

Our data sample includes data from 1981 to 2010 U.S. public firms traded on the NYSE, AMEX, or NASDAQ and consists of 50,998 firm-year observations for all firms, excluding utilities and financials, in the *Compustat* database, with publicly traded stock price observation in the *CRSP* database, incorporated in the U.S., and without missing observations for the dependent and independent variables for our baseline pooled panel regression model.

4.1 Dependent Variables

Management

Earnings Management

For H1a, we measure the level of earnings management using the Dechow and Dichev (2002) method which focuses on matching function of accruals to cash flows. Earnings quality is derived as the standard deviation of the residuals from regressions of changes in working capital on past, present, and future operating cash flows:

$$\Delta WC_t = \beta_0 + \beta_1 CFO_{t-1} + \beta_2 CFO_t + \beta_3 CFO_{t+1} + \varepsilon_{i,t}, \quad (1)$$

where ΔWC_t denotes change in working capital at time t , CFO_{t-1} , CFO_t , CFO_{t+1} denotes cash flow from operations at time $t-1$, t , and $t+1$, respectively. Therefore, the residuals reflect the accruals that are unrelated to cash flow realizations (Dechow and Dichev 2002). Higher standard deviation of residuals corresponds to lower earnings quality. As an alternative, we measure earnings management using the modified Jones model (Dechow et al. 1995), estimating the following regression for each Fama and French industry for each year between 1981 and 2010 for abnormal accruals:

$$\frac{TA_{i,t}}{Assets_{i,t-1}} = \alpha_0 \frac{1}{Assets_{i,t-1}} + \beta_1 \frac{\Delta Sales_{i,t} - \Delta AR_{i,t}}{Assets_{i,t-1}} + \beta_2 \frac{PPE_{i,t}}{Assets_{i,t-1}} + \varepsilon_{i,t},$$

where $TA_{i,t}$ denotes total accruals for firm i during year t , computed as income before extraordinary items minus cash flow from operating activities adjusted for extraordinary items and discontinued operations, $Assets_{i,t-1}$ denotes total assets for firm i at the end of year t . $\Delta Sales_{i,t}$ denotes change in sales for firm i in year t , $\Delta AR_{i,t}$ denotes change in accounts receivable for firm i in year t , and $PPE_{i,t}$ denotes property, plant and equipment for firm i at the end of year t . Dechow *et al.* (1996) showed the pattern of discretionary accruals for firms subject to enforcement actions by the SEC. They show that these firms generally manipulate reported earnings from one to three years before being detected (see their Table 3) and that the overstated accruals of these firms typically reverse fairly quickly, with negative discretionary accruals following the prior positive ones in the years immediately following the periods of earnings manipulation.

Manager and Director Compensation

For H1b, following Frattaroli (2020), we use the logarithm of total compensation of CEOs and logarithm of total compensation of directors as other proxies (including earnings management) of managerial opportunism.

Other Stakeholders

For H2a, we examine the impact on labor, customers, and creditors.

Labor

We measure the impact on labor as amount spent on labor divided by sales in a given year (labor expense). In addition, to capture labor's response to these statutes, as a robustness check, we examine for any change in labor productivity and labor unionization in the wake of these statutes (see Appendix C). Labor productivity is measured as sales divided by employee count and profitability (logged) by employee count. Following Chen *et al.* (2011), labor unionization is measured as the proportion of employees in a state

divided by the total number of employees in the state. It is constructed on a state-by-state basis using the CSI database.

Customers

The impact on customers is examined using customer awareness, which is measured as the ratio of advertising expenses to sales following Manchiraju and Rajgopal (2017).

Creditors

To examine the impact on creditors, we examine how the interest coverage ratio changed before and after the constituency statute. The interest coverage ratio is measured as the ratio of interest paid to creditors by net income in a given year.

Investors

For H2b, we examine Price-to-Earnings Growth (PEG), excluding Extraordinary Items (diluted) to 3-Year past EPS Growth.

External Governance

For H3, we examine the change in proportion and in dollar value of major block holders (holdings by the Top 5 institutional investors) and of all the institutional investors. We use the Thompson Reuters 13-F database to construct these measures.

Robustness: Other Stakeholder Concerns

In addition to examining the firm's response toward non-shareholder stakeholders in the face of constituency statutes, as a robustness check, we also examine the impact from the perspective of stakeholders themselves (see Appendix D). We utilize four measures of "concerns" from the KLD database: environmental stewardship concerns (ENV-CON-NUM: Total Number of Environmental Concerns),

impact on community concerns (COM-CON-NUM: Total Number of Community Concerns), labor-management relations concerns (HUM-CON-NUN: Total Number of Human Rights Concerns), and discrimination and workplace diversity concerns (DIV-CON-NUM: Total Number of Diversity Concerns). For the analysis, we use the logarithm of one plus the number of concerns as the dependent variable.

The definitions of our variables and data sources are provided in Appendix A.

4.2 Independent Variable

Constituency Statutes

We use the enactment of constituency statutes as an exogenous shock to examine the impact of introducing the ‘right’ to accommodate stakeholder interests, rather than the ‘duty’ to prioritize only shareholder interests. *Statute* is an indicator variable that equals one in the effective year and afterwards for all firms incorporated in the adopted states; zero otherwise for years before the effective date or for firms incorporated in states that never introduced constituency statutes. We construct *Statute* using incorporation-year observations (see Karpoff and Wittry 2018).

4.3 Control Variables

We consider the following control variables shown by the corporate transparency literature to be related to earnings management: firm size, leverage, ROA, and institutional ownership. Firm size is measured as log of total assets. Leverage is the ratio of long-term debt to total assets. Return on assets (ROA) is measured as the ratio of net income to total assets. Institutional ownership is the percentage of outstanding shares owned by institutional investors. We also include dummies for four other common antitakeover laws (Karpoff and Wittry 2018): *Business Combination Law*, *Control Share Law*, *Fair Price Law*, and *Poison Pill Law* (see Appendix E for an explanation of these laws). Such law changes have been shown to affect agency conflicts (Jayaraman and Shivakumar 2013).

5 EMPIRICAL SPECIFICATION

5.1 Main Regression Specification

To examine how the shift from ‘duty’ to ‘right’ may create trade-offs between different constituencies, we use staggered state-level adoption of constituency statutes as an exogenous shock. The adoption of constituency statutes can resolve endogeneity concerns as they are passed by individual states and are not endogenously driven by firm-specific conditions. We use the difference-in-difference specification suggested in Bertrand and Mullainathan (2003: 1057).¹ The regression specification is as follows:

$$Y_{i,t} = \alpha + \beta_1 Statute_{i,t} + \beta_2 L_{i,t} + \beta_3 X_{i,t} + \gamma_{firm} + \gamma_{year} + \varepsilon_{i,t}, \quad (2)$$

where Y is the main dependent variable and $Statute$ is an indicator variable, which takes value 1 for the year and after if a firm is incorporated in a state that adopted a constituency statute, otherwise zero. L is a vector of dummies for anti-takeover laws other than constituency statutes. X is a vector of firm fundamentals (e.g., ROA). β_1 is the coefficient of interest and it compares firms in states that enacted statutes versus firms in states that have not for the dependent variable of interest (e.g., corporate transparency, labor expense ratio, etc.).

In terms of specification, we include firm and year fixed effects to mitigate the impact of unobservable factors. We believe that our empirical specification provides a strong identification strategy; we avoid controlling for year on headquarter state fixed effects (e.g., Armstrong et al. 2012; Gao et al. 2020) because that would raise concerns about causal inference from the statute variable (which is similar to an interaction term between year and incorporation state). Thus, we feel confident in our results when compared to alternative specifications.² To account for serial correlation due to the error term, we also cluster standard errors by the state of incorporation.

¹ Bertrand and Mullainathan (2003) used incorporation fixed effects as an additional control for their plant level analysis. Just as a plant location can be changed to other states, so can a firm’s state of incorporation be changed (Bebchuk and Cohen 2003).

² We attempt to replicate Cremers et al. (2019) with correct empirical specification, i.e. including the incorporation state fixed effects, firm and year fixed effects. We find weak results using the modified Tobin’s Q as a dependent variable for the shareholder benefit model. These results are available upon request.

5.2 Nearest Neighbor Matching

In difference-in-difference specification, there are two control groups – the same firms in the same incorporation state after the adoption of constituency statutes and the firms in the other states that have not adopted such statutes. There is no issue surrounding the first set of control firms as these are the same firms before and after the shock. However, there is a possibility that firms in the second set of controls are different from the firms in the treatment group on firm fundamentals due to entry and exit from the state. To mitigate such concerns, we match the firms in the treatment group with the firms in the second set of controls on firm fundamentals. As firm-level controls are all continuous variables, we use approximate matching with the nearest neighbor algorithm. For each firm in the treatment group, we have a representative firm in the control group. The representative control firm is the weighted average of three firms from the second set of controls. The weights are decided by the nearest neighbor algorithm based on optimization.³

5.3 Two -Stage Least Square Regression

There is also a possibility that constituency statutes as an anti-takeover law may not be orthogonal to the other anti-takeover laws mentioned above. If true, then the estimated β_1 would be biased and not properly identified. To mitigate such concerns, we also run two-stage least square regression with the following specification.

$$Statute_{i,t} = \alpha + \eta_1 L_t + \eta_2 X_{i,t} + \gamma_{firm} + \gamma_{year} + \varepsilon_{i,t} \quad (3)$$

$$Y_{i,t} = \alpha + \beta_1 Residual_{i,t} + \beta_2 L_t + \beta_3 X_{i,t} + \gamma_{firm} + \gamma_{year} + \varepsilon_{i,t} \quad (4)$$

In the first stage (3), we run a logistic regression predicting the adoption of a constituency statute on the vector of anti-takeover laws and estimate the residual term. In the second stage (4), the regression of

³ For the robustness check, we also try different number of neighbors from the second set of controls, but the results are the same.

earnings management is run on the residual term from the first stage with all the controls, including the antitakeover laws. Similar to the main specification, we also use firm fixed effects, year fixed effects, and clustering of errors at incorporation state in both stages.

6 RESULTS AND DISCUSSION

6.1 Descriptive Summary

Table 1 shows the distribution of observations by the state of incorporation of the firms. Most observations are concentrated in Delaware but, excluding Delaware, are found in New York, Ohio, Florida, and Pennsylvania. Table 2 shows the yearly distribution of the observations; note that observations are evenly distributed over the years. Table 3 illustrates the descriptive statistics of the sample. We winsorize all continuous variables at the 1 and 99 percent levels to avoid the effects of influential outliers. The average earnings management is 7.06% with standard deviation of 12.5%, which is comparable to Dechow and Dichev (2002). Firm size has a mean of 5.79 and a standard deviation of 1.94. Leverage ratio is 0.23 on average with standard deviation of 0.21. The mean value of ROA is 0.10 and the standard deviation is 0.18. The mean value of institutional ownership is 0.46 and the standard deviation is 0.27.

[Insert Tables 1, 2 & 3 About Here]

6.2 Main Results

Table 4 shows the difference-in-difference regression results for the impact of constituency statutes on earnings management, a key measure of managerial entrenchment (Bertrand and Mullainathan 2003; Francis et al. 2005). The coefficient on *Statute* is positive and significant at 5% for the baseline scenario, and remains positive and significant at 1% after controlling for other most common antitakeover laws and firm characteristics. In Model 3, the *Statute* coefficient value of 0.571 implies that earnings management increased for firms incorporated in states that enacted constituency statutes. In terms of the magnitude of the change, the coefficient of 0.571 equates to about 8.09% (i.e., $0.571/7.06$) of the mean earnings management of our sample. The results support Hypothesis 1a. As a reference, in a recently published paper that uses the exact same measure of discretionary accruals, Beuselinck et al. (2019) found that the mean

value of signed discretionary accruals for subsidiaries of multinational corporations (MNCs) across 89 different countries is -0.002 (std dev. 0.195). This means that the effect size of constituency statutes on transparency is multi-fold that of the effect seen at the average MNE subsidiary around the world.

We should note that the coefficients for *Control Share Law*, *Business Conditions Law*, *Fair Price Law*, and *Poison Pill* are generally not statistically significant in our difference-in-difference specification, suggesting that these laws had little or no effect on earnings management using a difference-in-difference methodology. *Firm size* and *ROA* are negatively associated with earnings management (at the 1% level), and *Leverage* is positively associated with earnings management. These results are consistent with the existing literature on this subject. *Institutional Ownership* is negatively and significantly related to earnings management.

[Insert Table 4 About Here]

Because Table 4 provides support to the argument that constituency statutes may have opened the door to managerial entrenchment, Table 5 examines alternative ways of measuring entrenchment. Table 5 Model 1 re-examines the fully nested model of Table 4 (Model 3) using the modified Jones (1991) measure of earnings management. The results are confirmed but with a slightly lower significance level. We also examine (logged) compensation to both CEOs (Model 2) and directors (Model 3), observing a positive and 1% significant association between the adoption of constituency statutes and compensation for both. This indicates that both CEOs and directors engaged in enrichment activities when constituency statutes were adopted. Altogether, these results confirm concerns that by relaxing the governance regime, constituency statutes facilitated managerial entrenchment (and enrichment at the expense of shareholders).

[Insert Table 5 About Here]

Supporters of constituency statutes may argue that observers should not be surprised that shareholder concerns may not be always prioritized under such statutes, which were specifically architected to allow managerial discretion to include other stakeholders that previously had been ignored under the ‘duty’ regime of shareholder primacy. Therefore, it is important to assess if other stakeholders actually did benefit from the shift from ‘duty’ to ‘right’ as part of a trade-off with shareholders.

Table 6 captures the impact of constituency statutes on key stakeholder groups—labor, customers, creditors and investors. The coefficient for *Statute* in Model 1 and Model 2 is positive but not statistically significant, suggesting that the adoption of constituency statutes did not benefit labor (in terms of earnings as a share of total firm sales) and customer awareness (in terms of customer outreach via advertising spend as a share of total firm sales). Meanwhile, Model 3 shows that the coefficient for *Statute* is negative and statistically significant at 10%, suggesting the constituency statutes actually impairs creditors’ interests. Specifically, the coverage ratio decreased by 8.956 for firms incorporated in states with constituency statutes. These results confirm Hypothesis 2a that stakeholders of firms incorporated in a state with a constituency statute do not enjoy additional benefits from the firm as part of a trade-off with shareholder interest. Finally, we examine Price-to-Earnings Growth (PEG), which is a measure of whether shareholder interests are being helped or harmed. Unfortunately for shareholders, we observe that PEG was negatively impacted for firms incorporated in states that adopted constituency statutes. This supports H2b, further confirming that shareholders were harmed in measurable ways by the introduction of constituency statutes.

[Insert Table 6 About Here]

Table 7 captures the relationship between constituency statutes and external governance proxied by institutional ownership. We use three alternative measures for institutional ownership, including the percentage change of top 5 institutional investor holdings, the proportion of block holders to total institutional investors by count and by dollar value. Model 1 shows the impact of constituency statutes on ownership of blockholders (top 5 institutional investors) with respect to total ownership by institutional investors. The coefficient for *Statute* is -0.014 and statistically significant at 10%, suggesting that the major institutional holders reduce their ownership by 2.45% ($= -0.014/0.57$) from firms incorporated in states that adopted constituency statutes. Model 2 shows the impact of statutes on the proportion of block holders, the coefficient of *Statute* is -0.008 and statistically significant at 1%, implying that the proportion of block holders reduced by 20% ($= -0.008/0.04$) for firms incorporated in such states. Lastly, Model 3 shows the impact of statutes on ownership of block holders with respect to total ownership by dollar value by institutional investors. The coefficient of *Statute* is -0.02 at a 5% significance level, implying that block

holders reduce their ownership by 5.4% ($= -0.02/0.37$) from firms incorporated in states where constituency statutes were adopted. These results support H3.

As we argued earlier, constituency statutes lower the ability of shareholders to demand accountability or even ‘fair treatment’ in the allocation of finite resources. The exit of institutional investors as large block shareholders in firms located in constituency statute states suggests either that returns to these firms are less than what could be achieved in non-constituency statute states and/or the ability of institutional investors to influence firms in these states is lower. Nevertheless, an important member of the governance structure of firms—institutional investor holdings—shrinks in the face of the passage of constituency statutes.

[Insert Table 7 About Here]

6.3 Robustness Checks

We conduct a series of robustness checks to address potential confounds. In Table 8, we employ two-stage least square (2SLS) regression to alleviate concerns regarding the potential confounding effect of other anti-takeover laws on earnings management. We first regress the statute dummy on the vector of anti-takeover laws and then use the estimated residual term to explain earnings management. Our results hold at the 5% level for changes in transparency. The results demonstrate that after taking into account potential confounding effects from the set of anti-takeover laws, we still observe a positive and significant association between the adoption of constituency statutes and earnings management.

[Insert Table 8 About Here]

In Table 9, we rerun our difference-in-difference regression on a matched sample (i.e., firms in constituency statutes adopted states versus firms in other states) using the nearest neighbor propensity score matching method. We match firms using four covariates: Firm size, ROA, Leverage, and Institutional Ownership. The results are very similar to our main findings for earnings management shown in Table 4. The coefficient of *Statute* is 0.456 and statistically significant at the 10% level with control variables. Here we discuss the post-matching results only for the earnings management variable, however, we have similar results for other dependent variables. For those results, see Table 1A-5A in the Online Appendix.

[Insert Table 9 About Here]

In Table 10, we test for any potential sample selection biases in the state of incorporation and with respect to earnings management. One may argue that because most of the firms in the U.S. are incorporated in Delaware, the control group is biased toward one state (approximately 70.9% of our sample are firms incorporated in Delaware), which might create some sort of empirical bias. To mitigate this concern, in Table 10, Model 1, we remove the observations for firms incorporated in Delaware and conduct the difference-in-difference analysis again. In this robustness check, we find that even after removing the firms incorporated in Delaware, our results remain robust and statistically significant. The coefficient of *Statutes* is 0.545 and it is significant at the 5% level.

In Table 10, Model 2, we try to resolve another possible econometric concern. Even if we include year fixed effects and firm fixed effects, and cluster errors at the incorporation level, there is a possibility that the headquarters state and incorporation state are the same. To avoid this issue yet verify the strength of our results, we excluded the observations from the sample if the incorporation state and headquarters state are the same. As shown in Table 10, Model 2, the direction of our variable of interest *Statute* is consistent with our main findings, but no longer statistically significant.

[Insert Table 10 About Here]

Finally, there is a possibility that firms adjusted to the change in governance regime that constituency statutes enacted at different timings. Therefore, in Table 11, we explore the temporal dynamics of the treatment variable (*Statute*), comparing three years before the adoption year of a constituency statute to three years after the adoption year. The results show that the impact of constituency statutes on earnings management took place in the year of adoption of the statute (*Statute*), as well as in the year immediately preceding the statute's adoption (*Statute (-1)*), both coefficients are positive and significant at the 1% and 5% level, respectively. The positive and significant result of *Statute (-1)* implies that managers and directors took anticipatory actions in advance of the actual adoption of constituency statutes, most likely due to the public discourse surrounding the legislation prior to its enactment. Lawmaking is an arduous process and is rarely a "surprise" before being enacted.

[Insert Table 11 About Here]

The Appendix contains several alternative measures of firms addressing non-shareholder stakeholder concerns. Appendix C presents results for the impact of constituency statutes on alternative measures of labor. Model 1 shows the impact on SG&A Expense-to-Sales ratio (wherein employee costs usually constitute a large portion of SG&A expenses). Model 2 shows the impact on the (logged) EBITDA-to-Employee Cost ratio. Model 3 shows the impact on labor productivity. And Model 4 shows the impact on state-level labor unionization. Of all four alternative measures of labor, only state-level labor unionization levels were impacted positively (at the 5% level) by the adoption of constituency statutes. None of the firm-level measures, which would capture directors and managers allocating benefits to labor, are statistically significant.

Appendix D shows the KLD stakeholder concern measures. Despite the intent of the architects of constituency statutes to try to create allocative benefits to non-shareholder stakeholders, we observe statistically significant increases in concerns (rather than their reduction) with respect to community involvement (at the 10% level), employee relations (at the 5% level) and diversity (at the 1%). Only environmental concerns decrease (at the 1% level) in the face of the adoption of constituency statutes.

Further robustness checks are available in the Supplemental Material attachment.

6.4 Endogeneity of Constituency Statutes and Robustness Tests

Recent literature in finance (e.g., Karpoff and Wittry 2018) and in law (e.g., Catan and Kahan 2016) discusses how anti-takeover laws are not completely exogenous due to lobbying efforts (Karpoff and Wittry (2018), the myriad purposes in introducing the laws (Cremers et al. 2019), and the different forms of adoption – voluntary, mandatory, and opt-in (Adams and Matheson 2000). To assure that our main results are not driven by these events, we conduct additional robustness checks. Following Karpoff and Wittry (2018), we exclude the five states (i.e., Arizona, Indiana, Massachusetts, Minnesota, and Pennsylvania) where statute adoption happened due to some kind of lobbying. In a different test, we exclude the nine states (i.e., Iowa, Kentucky, Louisiana, Maryland, Missouri, Oregon, Rhode Island, South Dakota, and

Tennessee) where the reason for statute adoption has been attributed entirely to preventing hostile takeovers and not related to stakeholder governance (Cremers et al. 2019). Lastly, as adoption of statutes happened in different forms in different states, we conduct analyses for the state (i.e., Connecticut) where statutes were mandatory (Adams and Matheson 2000; Cremers et al. 2019). The results for these tests are provided in Internet Appendix and support our main findings showing an increase in earnings management following the CS adoption.⁴

6.5 Biased Correction in Difference-in-Difference Estimator

For many years, scholars have used a staggered Difference-in-Difference (DiD) methodology for causal interpretation, but recent work in econometrics has raised concerns about implementing a staggered DiD design with a multiple time-period and multiple group setup (Callaway and Sant’Anna 2020; de Chaisemartin and D’Haultfœuille 2020; Sant’Anna and Zhao 2020; Baker et al. 2021). The main argument is that the traditional DiD estimator – i.e., the Average Treatment of Treated Group (ATT) – is not completely unbiased because the already treated unit (in our case, state) is used as a control group for the unit getting treatment. Therefore, only ‘untreated’ units and ‘not yet treated’ units can be the actual control group. As in staggered DiD, units get treatment in different time periods. Units getting treated late have fewer units of actual control groups. Thus, this different timing of treatment of different units leads to biases in traditional estimation. To confirm that the statistical significance of our results is unaffected by this bias, we re-run the main regression using the three methodologies – Goodman-Bacon (2021), Callaway and Sant’Anna (2020), and stacked regression.⁵ Results for these tests are provided in Table 6A.

⁴ In addition, to checking for exogeneity of constituency statute adoption with regards to our main dependent variable, state economic and political conditions, we employ a Weibull hazard model where adoption is treated as a “failure event” (Gao et al. 2020; Ni 2020). Explanatory variables are measured on a state level and are lagged by one year. We also include other main anti-takeover laws as control variables. State-level variables include state GDP, population, unemployment rate, and a political climate variable, which is proxied by the political party of the governor. Coefficients for earnings management are not significant, indicating that adoption of constituency statutes is not related to existing earnings management in the state. This finding supports the assumption that CS adoption is exogenous to earnings management. Results for this test are provided in the Internet Appendix.

⁵ We use these three methodologies because these are most well-known. Goodman-Bacon (2021) and Callaway and Sant’Anna (2020) are two early studies which argue against the traditional DiD estimator.

As Goodman-Bacon (2021) methodology is applicable to balanced panels, we conduct this test only for sub-sample and generate the ATT. We also show the decomposition of DiD estimator, graphically. The Goodman-Bacon (2021) DiD estimator is,⁶

$$ATT (Goodman Bacon) = \sum_{g \neq U} ATT_g \times W_g^T$$

where W_g^T is a function of the decomposition weights, and is a combination of sample shares and treatment variance. The ATT is 1.027 and it is significant at 10 % level which supports our main result. The detailed results and DiD decomposition graph are available in Table 6A. The Callaway and Sant'Anna (2020) methodology has an advantage over the Goodman-Bacon (2021) methodology in that it is applicable to unbalanced panels as well. Callaway and Sant'Anna (2020) define the ATT for a timing group g (i.e., all firms that receive treatment during a certain period) at a point-in-time (called the group-time average treatment effect); their ATT is interpreted as:

$$ATT(g, t) = E[Y_t(g) - Y_t(0) | G_g = 1],$$

more specifically,

$$ATT(g, t) = E \left[\left\{ \frac{G_g}{E[G_g]} - \frac{\frac{p_g(X)C}{1 - p_g(X)}}{E \left[\frac{p_g(X)C}{1 - p_g(X)} \right]} \right\} (Y_t - Y_{g-1}) \right]$$

where G is a binary variable that is equal to 1 if a firm is treated in period g , C is a binary variable equal to 1 for firms in the control group, and p is weights that are assigned to balance the treatment and control group.

While conducting the analysis, we drop the firms incorporated in Nebraska to avoid potential biasness; Nebraska first adopted a constituency statute in 1988, repealed it effective in 1995 and reenacted one effective in 2007. To estimate the group-time average treatment effects, we use the double-robust method and include bootstrap with 1,000 iterations. We regress the earnings management on constituency statutes using the aforementioned identification. The result shows that the coefficient of group-time average

⁶ To conduct the analysis, we use the 'BACONDECOMP' package in STATA.

treatment effect is 0.011 with t-stats equal to 1.16 (significant at 12.3 % level). This suggests that with more rigorous econometric identification, the adoption of constituency statute has a positive impact on earnings management. Detailed results are provided in Table 6A.

Lastly, we use stacked regression to confirm that our results are robust to different forms of DiD estimator. By stacking and aligning events in event-time, this approach is equivalent to a setting where the events happen contemporaneously. Similar to the other two methods, it also prevents using past treated units as effective comparison units, which may occur with a staggered design. The coefficient of interest (β_1) is 0.571 and it is significant at 10% level. Detailed results are available in Table 6A. The results of these three tests confirm that our findings are robust event to stringent DiD estimators.

6.6 Constituency Statutes Adoption and Shareholders Reaction

As with numerous past studies related to anti-takeover laws (e.g., Frattaroli 2020), we use an event-study methodology to analyze shareholder reaction. In our context, we are evaluating the impact of CS on shareholder wealth. Based on CS adoption announcement dates from Karpoff and Wittry (2018), our sample has 653 unique events. However, 30 events were dropped due to a lack of returns observations in the estimation period. We do the computation using the market model with an estimation window from 240 days to 20 days before the event and generate the cumulative abnormal returns (CAR) for two event windows – short window (CAR(-1,1)) and long window (CAR(-5,5)). The CAR (-1,1) and CAR (-5,5) are -1.9 % and -3.8 %, which suggests that shareholder wealth was reduced following CS adoption, which is an indicator of managerial entrenchment. Detailed results for the event study are provided in Table 7A.

7 CONCLUSION

This paper revisits decades-old, but still continuous, debate on the ‘objective of the firm,’ i.e., whether firms should adopt ‘stakeholder governance’ (also called ‘conscious capitalism’) or maintain ‘shareholder primacy.’ In the past, numerous studies have examined the impact of the former on a particular stakeholder and its wealth, such as firm value (shareholders), cost of debt (creditors), and the like. In contrast to those

studies, we examine whether the shift to stakeholder governance represents a zero-sum game—wherein wealth transfer happens from shareholders to other stakeholders—or is Pareto optimal solution—wherein shareholders do not lose wealth but other stakeholders benefit. As in both situations, adopting stakeholder governance but allowing managerial discretion on following it may give rise to managerial entrenchment. Therefore, we examine managerial entrenchment and the cost and benefits to all major stakeholders together to provide a more complete picture.

Leveraging the staggered adoption of state-level constituency statutes across the United States, we examine whether the shift in governance regime afforded by such statutes opened the door for directors and managers to trade-off the interests of shareholders with the interests of other stakeholders, or whether said statutes facilitated managerial entrenchment at the expense of all stakeholders. Relying on three rationales—stretched resources, stretched board members and managers, and an entrenchment mindset among managers aware of the stretched board members—we find empirical support that firms not only shifted away from prioritizing shareholder concerns, but also that the shift did not accompany greater attention toward other stakeholder concerns. Our findings accord with work by Liu et al. (2019) and Bebchuk and Tallarita (2020) that there is a cost to taking into account stakeholder interests, that board member monitoring is compromised in the face of distractions (Tuggle et al. 2010; Renjie and Verwijmeren 2019), and that entrenched managers are associated with lower levels of transparency (Shleifer and Vishny 1997; Hermalin and Weisbach 2012).

While prior work has also documented benefits to non-shareholder stakeholders, including greater board representation (Luoma and Goodstein 1999) and increased corporate social responsibility (CSR) activity (Flammer 2015), we do not find commensurate benefits to labor, customers or creditors. “The threshold has moved substantially for what people expect from a company,” said Klaus Schwab, Chairman of the World Economic Forum, in a recent interview, adding: “It’s more than just producing profits for the shareholders” (Gelles and Yaffe-Bellany 2019: A1). Our paper contributes toward the current debate on the ‘objective of the firm’ by showing that adoption of stakeholder governance without addressing its

challenges (such as lack of managerial accountability) may affect investors negatively and may not benefit other stakeholders who could otherwise benefit.

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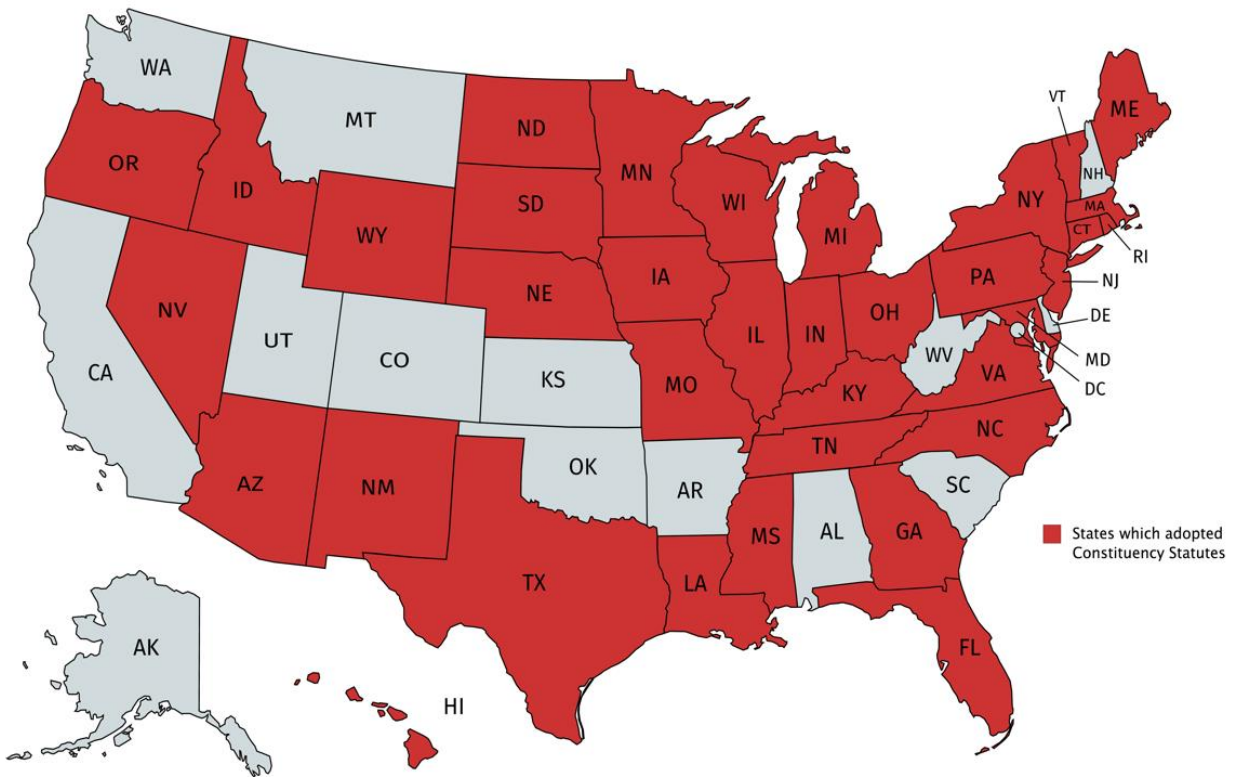


Fig. 1 States' adoption of constituency statutes. This figure shows the states that adopted constituency statutes (darker color) and those that did not (lighter color).

Table 1 State-level data

| Incorporation State | Adoption Year | Frequency | Percent | Cumulative |
|---------------------|-------------------------------|-----------|---------|------------|
| AL | n/a | 103 | 0.20 | 0.20 |
| AR | 1987 | 45 | 0.09 | 0.29 |
| AZ | 1987 | 29 | 0.06 | 0.35 |
| CA | n/a | 1,734 | 3.40 | 3.75 |
| CO | n/a | 280 | 0.55 | 4.30 |
| CT | 1997 | 207 | 0.41 | 4.70 |
| DC | n/a | 16 | 0.03 | 4.73 |
| DE | n/a | 36,157 | 70.90 | 75.63 |
| FL | 1989 | 459 | 0.90 | 76.53 |
| GA | 1989 | 445 | 0.87 | 77.40 |
| HI | 1989 | 26 | 0.05 | 77.46 |
| IA | 1989 | 143 | 0.28 | 77.74 |
| ID | 1988 | 4 | 0.01 | 77.74 |
| IL | 1985 | 109 | 0.21 | 77.96 |
| IN | 1989 | 460 | 0.90 | 78.86 |
| KS | n/a | 124 | 0.24 | 79.10 |
| KY | 1989 | 69 | 0.14 | 79.24 |
| LA | 1988 | 52 | 0.10 | 79.34 |
| MA | 1989 | 779 | 1.53 | 80.87 |
| MD | 1999 | 400 | 0.78 | 81.65 |
| ME | 1986 | 51 | 0.10 | 81.75 |
| MI | n/a | 709 | 1.39 | 83.14 |
| MN | 1987 | 715 | 1.40 | 84.54 |
| MO | 1989 | 242 | 0.47 | 85.02 |
| MS | 1990 | 44 | 0.09 | 85.11 |
| MT | n/a | 21 | 0.04 | 85.15 |
| NC | 1993 | 268 | 0.53 | 85.67 |
| NE | 1988 (repealed in 1995), 2007 | 58 | 0.11 | 85.79 |
| NH | n/a | 22 | 0.04 | 85.83 |
| NJ | 1989 | 522 | 1.02 | 86.85 |
| NM | 1987 | 12 | 0.02 | 86.88 |
| NV | 1991 | 357 | 0.70 | 87.58 |
| NY | 1987 | 1,263 | 2.48 | 90.05 |
| OH | 1984 | 810 | 1.59 | 91.64 |
| OK | n/a | 173 | 0.34 | 91.98 |
| OR | 1989 | 267 | 0.52 | 92.50 |
| PA | 1990 | 864 | 1.69 | 94.19 |
| RI | 1990 | 54 | 0.11 | 94.30 |
| SC | n/a | 138 | 0.27 | 94.57 |
| SD | 1990 | 46 | 0.09 | 94.66 |
| TN | 1988 | 236 | 0.46 | 95.13 |
| TX | 2006 | 527 | 1.03 | 96.16 |
| UT | n/a | 281 | 0.55 | 96.71 |
| VA | 1988 | 530 | 1.04 | 97.75 |
| VT | 1998 | 41 | 0.08 | 97.83 |
| WA | n/a | 701 | 1.37 | 99.21 |
| WI | 1987 | 384 | 0.75 | 99.96 |
| WV | n/a | 21 | 0.04 | 100 |
| Total | | 50,998 | 100 | |

^a This table shows years of constituency statute adoption and sample distribution by firm state of incorporation.

Table 2 Yearly distribution of the sample

| Year | Frequency | Percent | Cumulative |
|-------|-----------|---------|------------|
| 1981 | 760 | 1.49 | 1.49 |
| 1982 | 855 | 1.68 | 3.17 |
| 1983 | 986 | 1.93 | 5.10 |
| 1984 | 1,186 | 2.33 | 7.43 |
| 1985 | 1,264 | 2.48 | 9.90 |
| 1986 | 1,397 | 2.74 | 12.64 |
| 1987 | 1,551 | 3.04 | 15.68 |
| 1988 | 1,572 | 3.08 | 18.77 |
| 1989 | 1,537 | 3.01 | 21.78 |
| 1990 | 1,528 | 3.00 | 24.78 |
| 1991 | 1,509 | 2.96 | 27.74 |
| 1992 | 1,610 | 3.16 | 30.89 |
| 1993 | 1,729 | 3.39 | 34.28 |
| 1994 | 1,914 | 3.75 | 38.04 |
| 1995 | 2,009 | 3.94 | 41.98 |
| 1996 | 2,157 | 4.23 | 46.21 |
| 1997 | 2,388 | 4.68 | 50.89 |
| 1998 | 2,369 | 4.65 | 55.53 |
| 1999 | 2,234 | 4.38 | 59.91 |
| 2000 | 2,170 | 4.26 | 64.17 |
| 2001 | 2,039 | 4.00 | 68.17 |
| 2002 | 1,891 | 3.71 | 71.88 |
| 2003 | 1,783 | 3.50 | 75.37 |
| 2004 | 1,793 | 3.52 | 78.89 |
| 2005 | 1,837 | 3.60 | 82.49 |
| 2006 | 1,822 | 3.57 | 86.06 |
| 2007 | 1,822 | 3.57 | 89.63 |
| 2008 | 1,804 | 3.54 | 93.17 |
| 2009 | 1,777 | 3.48 | 96.66 |
| 2010 | 1,705 | 3.34 | 100 |
| Total | 50,998 | 100 | |

^a This table shows the frequency distribution of the data in the main sample (1981-2010) by year.

Table 3 Descriptive statistics

| | Variable | Mean | Median | S.D. | Min | Max | Observations |
|----------------------------|---|-------|--------|--------|---------|--------|--------------|
| Dependent Variables | | | | | | | |
| Managerial Entrenchment | Earnings Management (D&D) | 7.06 | 3.88 | 12.54 | 0.07 | 231.59 | 38,437 |
| | Earnings Management (Jones) | 0.00 | -0.01 | 0.47 | -2.90 | 3.04 | 49,309 |
| | CEO Compensation (logged) | 6.98 | 6.97 | 0.82 | 0.69 | 11.41 | 5,102 |
| | Director Compensation (logged) | 3.61 | 3.64 | 0.78 | -0.51 | 6.95 | 4,840 |
| <i>Other Stakeholders</i> | | | | | | | |
| Investors | Top 5 Institutional Holders to Total Institutional Ownership (Dollar Value) | 0.57 | 0.53 | 0.22 | 0.21 | 1.00 | 45,239 |
| | Ratio of Block holders to Total Institutional Holders (Counts) | 0.04 | 0.02 | 0.06 | 0.00 | 0.31 | 45,239 |
| | Ratio of Block holders to Total Institutional Holders (Dollar Value) | 0.37 | 0.34 | 0.20 | 0.08 | 0.97 | 37,067 |
| | Price-to-Earnings Growth (PEG) | 1.41 | 0.50 | 3.66 | -3.20 | 26.94 | 22,428 |
| | | | | | | | |
| Customers | Customer Awareness (Ad Spend-to-Sales Ratio) | 0.01 | 0.00 | 0.03 | 0.00 | 0.18 | 47,233 |
| Labor | Labor Expense-to-Sales Ratio | 0.03 | 0.00 | 0.09 | 0.00 | 0.48 | 47,233 |
| | SGA-to-Sales Ratio | 0.31 | 0.23 | 0.33 | 0.02 | 2.49 | 45,327 |
| | Labor Unionization Percentage (state level) | 39.50 | 38.90 | 9.82 | 12.60 | 69.40 | 49,383 |
| | Labor Productivity (Sales-to-Employee Count Ratio) | 5.10 | 5.08 | 0.92 | -3.09 | 10.96 | 50,184 |
| | EBITDA-to-Employee Count Ratio (logged) | 3.04 | 3.00 | 1.25 | -5.66 | 10.70 | 43,437 |
| Creditors | Interest Coverage Ratio | 24.54 | 4.47 | 141.12 | -430.33 | 1,033 | 42,227 |
| Other Stakeholder Concerns | KLD Environmental stewardship concerns (logarithm of count + 1) | 0.15 | 0.00 | 0.37 | 0.00 | 1.95 | 12,981 |
| | KLD Community concerns (logarithm of count + 1) | 0.05 | 0.00 | 0.19 | 0.00 | 1.10 | 12,981 |
| | KLD labor-management relations concerns (logarithm of count + 1) | 0.30 | 0.00 | 0.40 | 0.00 | 1.61 | 12,981 |

| | | | | | | | |
|------------------------------|--|----------|--------|----------|-------|--------|--------|
| | KLD discrimination and workplace diversity concerns (logarithm of count + 1) | 0.29 | 0.00 | 0.37 | 0.00 | 1.39 | 12,981 |
| Independent Variables | | | | | | | |
| Constituency Statutes | Statute | 0.14 | 0.00 | 0.35 | 0.00 | 1 | 50,998 |
| Other Anti-Takeover Laws | Control Share Law | 0.14 | 0.00 | 0.34 | 0.00 | 1 | 50,998 |
| | Business Conditions Law | 0.79 | 1.00 | 0.41 | 0.00 | 1 | 50,998 |
| | Fair Price Law | 0.15 | 0.00 | 0.36 | 0.00 | 1 | 50,998 |
| | Poison Pill Law | 0.15 | 0.00 | 0.36 | 0.00 | 1 | 50,998 |
| Controls | Total Assets | 1,867.60 | 297.86 | 4,760.54 | 0.12 | 28,737 | 50,998 |
| | ROA | 0.10 | 0.13 | 0.18 | -0.84 | 0.40 | 50,998 |
| | Firm Size | 5.79 | 5.76 | 1.94 | 0.58 | 10.40 | 50,761 |
| | Leverage | 0.23 | 0.20 | 0.21 | 0.00 | 0.97 | 50,998 |
| | Institutional Ownership (in %) | 0.46 | 0.44 | 0.27 | 0.00 | 1.08 | 50,997 |

^a Table shows descriptive statistics of the variables included in analyses. *Earnings Management (D&D)* is measured based on Dechow and Dichev (2002). *Earnings Management (Jones)* is measured based on Jones (1991). *CEO Compensation (logged)* is the logarithm of CEO's total annual compensation (Frattaroli 2020). *Director Compensation (logged)* is the logarithm of total board member compensation (Frattaroli 2020). *Top 5 Institutional Holders* is the proportion of dollar value of shares held by top 5 institutional ownership to the total dollar value of shares held by all institutional holders. *Ratio of Block holders to Total Institutional Holders (Counts)* is the proportion of the number of block holders to the total number of institutional holders. *Ratio of Block holders to Total Institutional Holders (Dollar Value)* is the proportion of dollar value of shares held by block holders to the total dollar value of shares held by institutional holders. *Price-to-Earnings Growth (PEG)* is Price-to-Earnings, excl. Extraordinary Items (diluted) to 3-Year past EPS Growth. *Customer Awareness* is the ratio of advertisement expenditure to sales. *Labor Expense-to-Sales Ratio* is the amount spent on labor divided by sales in a given year. *Labor Unionization Percentage* is the percentage of workers of a state covered by labor unions. *Labor Productivity* is the ratio of sales divided by the logarithm of employee count. *EBITDA-to-Employee Ratio (logged)* is EBITDA divided by employee count, logged. *Coverage Ratio* is earnings before interest and tax scaled by interest expense. *Dividend Yield* is the dividend per share scaled by stock price per share. The *Other Stakeholder Concerns* data comes from the KLD database: *environmental stewardship concerns* (ENV-CON-NUM), *impact on community concerns* (COM-CON-NUM), *labor-management relations concerns* (HUM-CON-NUN), and *discrimination and workplace diversity concerns* (DIV-CON-NUM); we use the logarithm of one plus the number of concerns. *Statutes* is a dummy variable with value 1 for a year when the firm incorporated in a state that adopted a constituency statute and after that; otherwise 0. *Control Share Law*, *Business Conditions Law*, *Fair Price Law*, and *Poison Pill Law* are dummies for other anti-takeover laws at the state level (Karpoff and Wittry 2018). *Total assets* is the total assets of the firm. *ROA* is a return on assets measured as total earnings divided by total assets. *Firm Size* is the log value of total assets. *Leverage* is measured as the ratio of total debt to total assets. *Institutional Ownership* is the proportion of shares held by institutional investors.

Table 4 Constituency statutes and earnings management

| Variable | (1) EM (D&D) | (2) EM (D&D) | (3) EM (D&D) |
|--------------------------------|---------------------|---------------------|-----------------------|
| <i>Statute</i> | 0.547** (0.220) | 0.434** (0.209) | 0.571*** (0.204) |
| <i>Control Share Law</i> | | 0.086 (0.572) | -0.155 (0.615) |
| <i>Business Conditions Law</i> | | 0.092 (0.458) | 0.126 (0.550) |
| <i>Fair Price Law</i> | | 0.007 (0.315) | 0.385 (0.368) |
| <i>Poison Pill Law</i> | | 0.204 (0.291) | 0.212 (0.308) |
| <i>ROA</i> | | | -11.699*** (1.420) |
| <i>Leverage</i> | | | 1.813*** (0.566) |
| <i>Firm Size</i> | | | -0.929*** (0.045) |
| <i>Institutional Ownership</i> | | | -2.572*** (0.246) |
| Constant | 6.974*** (0.036) | 6.856*** (0.423) | 14.125*** (0.652) |
| Observations | 38,437 | 38,437 | 38,227 |
| R-squared | 0.580 | 0.580 | 0.597 |
| Firm Fixed Effects | Yes | Yes | Yes |
| Year Fixed Effects | Yes | Yes | Yes |
| Cluster (Incorporation State) | Yes | Yes | Yes |

^a This table shows the effect of constituency statutes on earnings management. The dependent variable, *EM (D&D)*, is earnings management measured based on Dechow and Dichev (2002). *Statutes* is a dummy variable with value 1 for a year when the firm incorporated in a state that adopted a constituency statute and after that; otherwise 0. All variables are as defined in Table 3. Standard errors are reported in parentheses. ***, **, and * denote statistical significance at the two-tailed 1%, 5%, and 10% level, respectively.

Table 5 Alternative measures of entrenchment

| Variable | (1) EM (Jones) | (2) CEO Compensation (logged) | (3) Director Compensation (logged) |
|--------------------------------|----------------------|-------------------------------------|--|
| <i>Statute</i> | 0.033* (0.018) | 0.229*** (0.051) | 0.698*** (0.037) |
| <i>Control Share Law</i> | -0.001 (0.015) | | |
| <i>Business Conditions Law</i> | -0.004 (0.010) | | |
| <i>Fair Price Law</i> | -0.025* (0.015) | | |
| <i>Poison Pill Law</i> | 0.047*** (0.016) | | |
| <i>ROA</i> | 0.398*** (0.065) | 0.582*** (0.127) | -0.094 (0.138) |
| <i>Leverage</i> | 0.068*** (0.019) | 0.167*** (0.036) | 0.163*** (0.016) |
| <i>Firm Size</i> | 0.152*** (0.020) | -0.269*** (0.043) | 0.060 (0.054) |
| <i>Institutional Ownership</i> | 0.004 (0.014) | 0.326*** (0.053) | 0.080*** (0.020) |
| Constant | -0.517*** (0.113) | 5.414*** (0.246) | 2.174*** (0.158) |
| Observations | 48,311 | 5,067 | 4,796 |
| R-squared | 0.158 | 0.653 | 0.666 |
| Firm Fixed Effects | Yes | Yes | Yes |
| Year Fixed Effects | Yes | Yes | Yes |
| Cluster (Incorporation State) | Yes | Yes | Yes |

^a This table shows the impact of constituency statutes on an alternative measure of earnings management (modified Jones), and on the logged compensation of CEO and board of directors. All variables are as defined in Table 3. Standard errors are reported in parentheses. ***, **, and * denote statistical significance at the two-tailed 1%, 5%, and 10% level, respectively.

Table 6 Stakeholders' interests and constituency statutes

| | (1) | (2) | (3) | (4) |
|--------------------------------|------------------------------|-------------------------|----------------|--------------------------------|
| | Labor | Customers | Creditors | Shareholders |
| Variable | Labor Expense-to-Sales Ratio | Ad Spend-to-Sales Ratio | Coverage Ratio | Price-to-Earnings Growth Ratio |
| <i>Statute</i> | 0.004 | 0.000 | -8.956* | -0.393* |
| | (0.005) | (0.001) | (4.471) | (0.212) |
| <i>Control Share Law</i> | -0.001 | -0.000 | -12.114* | 0.153 |
| | (0.006) | (0.001) | (7.121) | (0.211) |
| <i>Business Conditions Law</i> | -0.006 | 0.000 | -4.054 | -0.269* |
| | (0.005) | (0.001) | (5.090) | (0.152) |
| <i>Fair Price Law</i> | -0.000 | 0.001 | -2.261 | 0.162 |
| | (0.006) | (0.001) | (6.250) | (0.192) |
| <i>Poison Pill Law</i> | -0.009 | 0.000 | 8.318* | -0.053 |
| | (0.006) | (0.001) | (4.852) | (0.213) |
| <i>ROA</i> | -0.015*** | -0.006*** | 48.518*** | -1.478*** |
| | (0.005) | (0.001) | (9.032) | (0.288) |
| <i>Leverage</i> | -0.009 | 0.002 | -49.294*** | -0.401* |
| | (0.007) | (0.001) | (7.330) | (0.207) |
| <i>Firm Size</i> | 0.006*** | -0.000 | 11.685*** | 0.224*** |
| | (0.002) | (0.000) | (1.699) | (0.067) |
| <i>Institutional Ownership</i> | 0.006*** | -0.002*** | 38.589*** | 0.333 |
| | (0.002) | (0.001) | (4.146) | (0.323) |
| Constant | -0.004 | 0.014*** | -50.372*** | 0.375 |
| | (0.012) | (0.002) | (12.738) | (0.367) |
| Observations | 47,175 | 47,175 | 42,133 | 22,375 |
| R-squared | 0.823 | 0.814 | 0.439 | 0.216 |
| Firm Fixed Effects | Yes | Yes | Yes | Yes |
| Year Fixed Effects | Yes | Yes | Yes | Yes |
| Cluster (Incorporation State) | Yes | Yes | Yes | Yes |

^a This table shows the effect of constituency statutes on stakeholder welfare and shareholder interests. All variables are as defined in Table 3. Standard errors are reported in parentheses. ***, **, and * denote statistical significance at the two-tailed 1%, 5%, and 10% level, respectively.

Table 7 Institutional investors and constituency statutes

| Variable | (1) Pctg Change in number of Top 5 Institutional Holders | (2) Ratio of Block holders to Total Institutional Holders (Counts) | (3) Ratio of Block holders to Total Institutional Holders (Dollar Value) |
|--------------------------------|---|---|---|
| <i>Statute</i> | -0.014* | -0.008*** | -0.020** |
| | (0.008) | (0.003) | (0.010) |
| <i>Control Share Law</i> | -0.011 | 0.002 | 0.005 |
| | (0.010) | (0.003) | (0.011) |
| <i>Business Conditions Law</i> | 0.006 | -0.000 | 0.011 |
| | (0.007) | (0.003) | (0.011) |
| <i>Fair Price Law</i> | -0.009 | 0.002 | -0.015 |
| | (0.010) | (0.003) | (0.013) |
| <i>Poison Pill Law</i> | 0.006 | 0.002 | 0.003 |
| | (0.008) | (0.002) | (0.006) |
| <i>ROA</i> | -0.112*** | -0.024*** | -0.145*** |
| | (0.008) | (0.004) | (0.017) |
| <i>Leverage</i> | -0.074*** | -0.011*** | -0.053*** |
| | (0.007) | (0.001) | (0.006) |
| <i>Firm Size</i> | 0.153*** | 0.018*** | 0.122*** |
| | (0.007) | (0.003) | (0.007) |
| Constant | 0.973*** | 0.106*** | 0.665*** |
| | (0.041) | (0.006) | (0.035) |
| Observations | 44,278 | 44,278 | 36,141 |
| R-squared | 0.807 | 0.621 | 0.622 |
| Firm Fixed Effects | Yes | Yes | Yes |
| Year Fixed Effects | Yes | Yes | Yes |
| Cluster (Incorp. State) | Yes | Yes | Yes |

^a This table shows the effect of constituency statutes on number and ownership of institutional investors. All variables are as defined in Table 3. Standard errors are reported in parentheses. ***, **, and * denote statistical significance at the two-tailed 1%, 5%, and 10% level, respectively.

Table 8 Two-stage least square (2SLS) regression

| Variable | (1) Statute | (2) EM (D&D) |
|--------------------------------|----------------------|-----------------------|
| <i>Statute Residual</i> | | 0.045** (0.019) |
| <i>Control Share Law</i> | 2.346** (0.983) | 0.225 (0.550) |
| <i>Business Conditions Law</i> | 2.029** (0.899) | 0.100 (0.610) |
| <i>Fair Price Law</i> | 1.223 (0.765) | 0.819** (0.365) |
| <i>Poison Pill Law</i> | 4.747*** (0.807) | 0.502* (0.293) |
| <i>ROA</i> | | -11.684*** (1.429) |
| <i>Leverage</i> | | -0.938*** (0.048) |
| <i>Firm Size</i> | | 1.802*** (0.572) |
| <i>Institutional Ownership</i> | | -2.573*** (0.246) |
| Constant | -7.168*** (1.370) | 14.211*** (0.690) |
| Observations | 48,397 | 38,227 |
| R-squared (Pseudo R-squared) | 0.722 | 0.597 |
| Firm Fixed Effects | No | Yes |
| Year Fixed Effects | Yes | Yes |
| Cluster (Incorporation State) | Yes | Yes |

^a This table shows the effect of constituency statutes on earnings management with a two-stage least square regression. In the first stage, Model 1, the estimated regression is constituency statutes dummy (Statute) on four anti-takeover laws dummy variables—*Control Share Law*, *Business Conditions Law*, *Fair Price Law*, and *Poison Pill Law*. In the second stage, Model 2, the estimated regression is earnings management (EM (D&D)) on the fitted value from first stage (*Statute Residual*) with all the controls. All variables are as defined in Table 3. Standard errors are reported in parentheses. ***, **, and * denote statistical significance at the two-tailed 1%, 5%, and 10% level, respectively.

Table 9 Nearest neighbor propensity score matched sample*Panel A: Covariate Balance*

| Variable | Mean | | | t-test | |
|--------------------------------|---------|---------|--------|--------|------|
| | Treated | Control | % bias | t | p>t |
| <i>ROA</i> | 0.15 | 0.15 | -2.5 | -1.88 | 0.06 |
| <i>Firm Size</i> | 6.18 | 6.16 | 1.2 | 0.84 | 0.40 |
| <i>Leverage</i> | 0.23 | 0.23 | -1.8 | -1.31 | 0.19 |
| <i>Institutional Ownership</i> | 0.44 | 0.44 | -0.7 | -0.51 | 0.61 |

Panel B: OLS

| Variable | (1) | (2) |
|--------------------------------|---------------------|----------------------|
| | EM (D&D) | EM (D&D) |
| <i>Statute</i> | 0.649*** (0.203) | 0.456* (0.233) |
| <i>Control Share Law</i> | | 0.332 (0.602) |
| <i>Business Conditions Law</i> | | 0.288 (0.569) |
| <i>Fair Price Law</i> | | 0.244 (0.394) |
| <i>Poison Pill Law</i> | | 0.410 (0.301) |
| <i>ROA</i> | | 0.315 (0.696) |
| <i>Leverage</i> | | -0.891*** (0.086) |
| <i>Firm Size</i> | | 0.077 (0.333) |
| <i>Institutional Ownership</i> | | -1.863*** (0.470) |
| Constant | 5.109*** (0.070) | 11.091*** (0.963) |
| Observations | 18,129 | 18,129 |
| R-squared | 0.614 | 0.617 |
| Firm Fixed Effects | Yes | Yes |
| Year Fixed Effects | Yes | Yes |
| Cluster (Incorporation State) | Yes | Yes |

^a This table shows the effect of constituency statutes on earnings management with matched sample based on nearest neighbor matching. In Panel A, we present covariate balance of the matched sample. Panel B tests the effect of constituency statutes adoption on earnings management in the matched sample. All variables are as defined in Table 3. Standard errors are reported in parentheses. ***, **, and * denote statistical significance at the two-tailed 1%, 5%, and 10% level, respectively.

Table 10 Incorporation and headquarter state

| <i>Panel A: Delaware Incorporation</i> | | | | <i>Panel B: Incorporation – Headquarter State</i> | | | |
|--|-----------|---------|------------|---|-----------|---------|------------|
| Delaware Incorporation | Frequency | Percent | Cumulative | Incorporation State | Frequency | Percent | Cumulative |
| 0 | 14,841 | 29.1 | 29.1 | 0 | 39,267 | 77 | 77 |
| 1 | 36,157 | 70.9 | 100 | 1 | 11,731 | 23 | 100 |
| Total | 50,998 | 100 | | Total | 50,998 | 100 | |

| <i>Panel C: OLS</i> | | |
|--------------------------------|--|---|
| Variable | (1) Panel D: Excluding Delaware Firms EM (D&D) | (2) Panel E: Excluding Firms Where Incorp. State = HQ State EM (D&D) |
| <i>Statute</i> | 0.545** (0.242) | 0.256 (0.504) |
| <i>Control Share Law</i> | 0.353 (0.589) | 0.314 (0.852) |
| <i>Business Conditions Law</i> | 0.337 (0.538) | -0.351 (1.382) |
| <i>Fair Price Law</i> | 0.390 (0.431) | 1.400 (1.028) |
| <i>Poison Pill Law</i> | 0.348 (0.313) | 0.041 (0.266) |
| <i>ROA</i> | -4.870*** (1.308) | -13.058*** (0.351) |
| <i>Leverage</i> | -1.007*** (0.176) | -0.914*** (0.031) |
| <i>Firm Size</i> | -0.463 (0.791) | 2.299*** (0.264) |
| <i>Institutional Ownership</i> | -1.570*** (0.538) | -2.775*** (0.147) |
| Constant | 11.787*** (1.372) | 14.863*** (1.342) |
| Observations | 10,095 | 29,291 |
| R-squared | 0.516 | 0.551 |
| Firm Fixed Effects | Yes | Yes |
| Year Fixed Effects | Yes | Yes |
| Cluster (Incorporation State) | Yes | Yes |

^a This table shows the effect of constituency statutes on earnings management excluding the firm-year observations if the incorporation state is Delaware and if incorporation state and headquarter state are the same. In Panel A, we present sample distribution based on Delaware incorporation. Panel B presents sample distribution based on incorporation-headquarter state where *Incorporation Headquarter State* is equal to 1 if state of incorporation and state of headquarters are the same; otherwise 0. Panel C, Model 1 presents results excluding firms incorporated in Delaware, Panel C, Model 2 presents results excluding firms with the same state of incorporation and headquarters. All variables are as defined in Table 3. Standard errors are reported in parentheses. ***, **, and * denote statistical significance at the two-tailed 1%, 5%, and 10% level, respectively.

Table 11 Temporal dynamics

| | (1) | (2) | (3) | (4) | (5) | (6) | (7) |
|--------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| Variable | EM (D&D) | EM (D&D) | EM (D&D) | EM (D&D) | EM (D&D) | EM (D&D) | EM (D&D) |
| <i>Statute (-3)</i> | 0.737 (0.562) | | | | | | |
| <i>Statute (-2)</i> | | 0.611 (0.444) | | | | | |
| <i>Statute (-1)</i> | | | 0.570** (0.218) | | | | |
| <i>Statute</i> | | | | 0.571*** (0.204) | | | |
| <i>Statute (+1)</i> | | | | | 0.018 (0.260) | | |
| <i>Statute (+2)</i> | | | | | | -0.318 (0.226) | |
| <i>Statute (+3)</i> | | | | | | | -0.286 (0.185) |
| <i>Control Share Law</i> | 0.290 (0.486) | 0.293 (0.484) | 0.204 (0.485) | -0.155 (0.615) | 0.277 (0.482) | 0.465 (0.468) | 0.411 (0.470) |
| <i>Business Conditions Law</i> | 0.142 (0.457) | 0.172 (0.492) | 0.172 (0.525) | 0.126 (0.550) | 0.254 (0.553) | 0.317 (0.562) | 0.280 (0.558) |
| <i>Fair Price Law</i> | 0.618** (0.303) | 0.576* (0.320) | 0.490 (0.345) | 0.385 (0.368) | 0.486 (0.394) | 0.493 (0.402) | 0.561 (0.388) |
| <i>Poison Pill Law</i> | 0.168 (0.240) | 0.202 (0.253) | 0.222 (0.285) | 0.212 (0.308) | 0.350 (0.329) | 0.419 (0.366) | 0.403 (0.351) |
| <i>ROA</i> | -11.698*** (1.421) | -11.698*** (1.421) | -11.697*** (1.422) | -11.699*** (1.420) | -11.695*** (1.422) | -11.688*** (1.426) | -11.683*** (1.429) |
| <i>Leverage</i> | -0.930*** (0.045) | -0.930*** (0.045) | -0.929*** (0.045) | -0.929*** (0.045) | -0.930*** (0.046) | -0.932*** (0.046) | -0.934*** (0.046) |
| <i>Firm Size</i> | 1.817*** (0.563) | 1.815*** (0.564) | 1.815*** (0.565) | 1.813*** (0.566) | 1.809*** (0.569) | 1.806*** (0.570) | 1.805*** (0.571) |
| <i>Institutional Ownership</i> | -2.570*** (0.247) | -2.571*** (0.247) | -2.572*** (0.246) | -2.572*** (0.246) | -2.567*** (0.249) | -2.567*** (0.251) | -2.568*** (0.251) |
| Constant | 13.900*** (0.616) | 13.892*** (0.638) | 13.924*** (0.640) | 14.041*** (0.654) | 13.912*** (0.663) | 13.871*** (0.669) | 13.906*** (0.664) |
| Observations | 37,431 | 37,431 | 37,431 | 37,431 | 37,431 | 37,431 | 37,431 |
| R-squared | 0.544 | 0.544 | 0.544 | 0.544 | 0.544 | 0.544 | 0.544 |
| Firm Fixed Effects | Yes | Yes | Yes | Yes | Yes | Yes | Yes |
| Year Fixed Effects | Yes | Yes | Yes | Yes | Yes | Yes | Yes |
| Cluster (Incorp State) | Yes | Yes | Yes | Yes | Yes | Yes | Yes |

^a This table shows the dynamic effects of constituency statutes on earnings management. *Statute (-3)*, *Statute (-2)*, *Statute (-1)*, *Statute (+1)*, *Statute (+2)*, and *Statute (+3)* captures the dynamics of the treatment three years before the adoption year to three years after the adoption year of constituency statutes. All variables are as defined in Table 3. Standard errors are reported in parentheses. ***, **, and * denote statistical significance at the two-tailed 1%, 5%, and 10% level, respectively.

Appendix A Variable descriptions

| Variable | Definition | Data Source |
|---|--|--------------------------------|
| <i><u>Dependent variables</u></i> | | |
| Earnings Management (H1a) | Based on Dechow and Dichev (2002) method. | Compustat |
| CEO Compensation (logged) (H1b) | The logarithm of total compensation of the CEO. | Execucomp |
| Director Compensation (logged) (H1b) | The logarithm of total board member compensation. | Execucomp |
| Labor Expense-to-Sales Ratio (H2a) | Ratio of labor expenditure divided by sales. | Compustat |
| Ad Spend-to-Sales Ratio (H2a) | Ratio of advertising expenditure divided by sales. | Compustat |
| Interest Coverage Ratio (H2a) | Ratio of interest paid to creditors divided by net income. | Compustat |
| Price-to-Earnings Growth (H2b) | Price-to-Earnings, excl. Extraordinary Items (diluted) to 3-Year past EPS Growth. | Compustat |
| Top 5 Institutional Investors (H3) | Ownership (by dollar value) of the Top 5 institutional investors divided by total institutional ownership. | Thompson Reuters 13-F |
| Ratio of Block holders to Total Institutional Holders (Count) (H3) | Percentage of the number of block holders to the total number of institutional holders. | Thompson Reuters 13-F |
| Ratio of Block holders to Total Institutional Holders (Dollar Value) (H3) | Percentage of dollar value of shares held by block holders to the total dollar value of shares held by institutional holders. | Thompson Reuters 13-F |
| <i><u>Independent variable</u></i> | | |
| Statute | Dummy variable with value 1 for all years after the state of incorporation adopted constituency statutes (CS), otherwise 0. | Flammer and Kacperczyk (2015) |
| <i><u>Control variables</u></i> | | |
| <i><u>Firm Size</u></i> | | |
| ROA | The logarithm of total assets. | Compustat |
| Leverage | Ratio of return on assets, measured as net income divided by average total assets. | Compustat |
| Total Institutional Investors | Ratio of long-term debt divided by total assets. | Compustat |
| Institutional Ownership | Percentage of shares outstanding held by institutional investors. | Thompson Reuters 13-F |
| Control Share Law, Business Conditions Law, Fair Price Law, and Poison Pill Law | Percentage of institutional investor holdings in total shares available to the public. | Thompson Reuters 13-F |
| | Dummy variable equal to 1 for all years after the state of incorporation adopted any of these anti-takeover statutes, 0 otherwise. We follow Karpoff and Wittry (2018) to know the years of adoption in each state. See Appendix E for more details. | Karpoff and Wittry (2018) |
| <i><u>Robustness checks</u></i> | | |
| Earnings Management (H1a) | Based on modified Jones model (1991). | Compustat |
| Environmental Stewardship Concerns (H2b) | Log of total number of environmental concerns (ENV-CON-NUM) plus one. | KLD |
| Community Involvement Concerns (H2b) | Log of total number of community concerns (COM-CON-NUM) plus one. | KLD |
| Employee Relations Concerns (H2b) | Log of total number of human rights concerns (HUM-CON-NUN) plus one. | KLD |
| Diversity Concerns (H2b) | Log of total number of diversity concerns (DIV-CON-NUM) plus one. | KLD |
| SG&A-to-Sales Ratio (H2b) | Ratio of selling, general & administrative expenses divided by sales. | Compustat |
| EBITDA-to-Employee Ratio (log) (H2b) | Log(EBITDA/employee count). | Compustat |
| Labor Productivity (H2b) | Ratio of sales divided by the logarithm of employee count. | Compustat |
| Labor Unionization Percentage (H2b) | Percentage of workers covered by labor unions in each state. | Census Industry Classification |

Appendix B Managerial opportunism & stakeholder governance: Theoretical underpinnings

If directors and managers experience a shift in mentality from a ‘duty’ to prioritize only the needs of shareholders to the ‘right’ to accommodate the needs of multiple stakeholders, it is logical to presume that trade-offs between competing stakeholders may emerge. This can be shown analytically through a single period first order model in which directors have finite resources (e.g., budget, time, attention) to monitor managers, and through the adoption of constituency statutes, these resources would be split between monitoring the manager and in resolving the issues of various stakeholders. This weakening in monitoring by the board could aggravate moral hazard problems, which could be observed through reduced allocation to investors of something that has a non-zero cost (e.g., budget, time, attention) to provide, such as earnings transparency to investors (Ferreira and Laux 2007). Jensen and Meckling (1976) reflected precisely on this issue of resource limits in terms of effort and time of directors, writing:

“As it is used in this paper the term monitoring includes more than just measuring or observing the behavior of the agent. It includes efforts on the part of the principal to ‘control’ the behavior of the agent through budget restrictions, compensation policies, operating rules etc.”

Thus, agency cost can be defined as:

$$\text{Agency cost} = \text{Monitoring expenditure by the principal} + \text{Bonding expenditure by the agent} + \text{residual loss,}$$

where monitoring expenditure does not just include expenditures spent on monitoring managers but also contains resources such as effort and time spent by directors in monitoring the manager.

The level of resources that could be dedicated to the consideration of shareholder concerns will decline as resources come to be allocated to consideration of other stakeholders. Because constituency statutes directly articulate the shift from ‘duty’ to ‘rights’ of directors, if we assume that directors have R units of resources to allocate when engaging in decision-making, then under shareholder primacy:

$$R = R_{sh}$$

If we further assume that one corporate benefit that can be derived from the allocation of R_{sh} is firm transparency (inversely proportional to managerial opportunism or agency problem) toward shareholders and that transparency (T) is a function of the R_{sh} and A (the agency cost of monitoring managers), hence:

$$T = f(R_{sh}, A)$$

When all resources are spent on shareholders (i.e., there is no stakeholder orientation), then:

$$T = f(R, A)$$

When decision-makers may cater to other stakeholders (i.e., the presence of conscious capitalism), then for directors:

$$R = R_{sh} + R_{st}$$

Here, R_{sh} represents resources allocated to consideration of shareholder concerns, and R_{st} represents resources allocated to consideration of the concerns of other stakeholders. Therefore, if managers are accounting for any interests of other stakeholders, the transparency (T) function becomes:

$$T = f(R - R_{st}, A) \quad (1)$$

Assuming agency costs are constant, the first-order condition w.r.t. R_{st} is:

$$\frac{d(T)}{dR_{st}} = f'(R - R_{st}, A)(-1) \quad (2)$$

Equation (2) demonstrates that as stakeholder orientation increases via the introduction of constituency statutes (and resources spent on other stakeholders increase), firm transparency decreases.

Next, we relax the assumption that agency cost is constant, which would happen if managers themselves were indirectly influenced by constituency statutes even though no managerial duties are articulated in such statutes. Under this scenario, agency costs can be defined as a non-linear function of resources available to directors to look after shareholder interests:

$$A = \zeta (R - R_{st})^\eta \quad (3)$$

Here, η is a non-linearity parameter and ζ is a constant. Combining equation (3) and equation (1) results in transparency (T) function allowing for non-linear agency costs:

$$T = f(R - R_{st}, \zeta (R - R_{st})^\eta) \quad (4)$$

Assuming nonlinear agency costs, the first-order condition w.r.t. R_{st} is:

$$\frac{d(T)}{d(R_{st})} = f'(R - R_{st}, \zeta (R - R_{st})^\eta) [1 + \eta \zeta (R - R_{st})^{\eta-1}] (-1) \quad (5)$$

As $\eta > 0$, $\zeta > 0$, and $R - R_{st} > 0$, an increase in R_{st} will result in a decrease in transparency (T).

This model shows that regardless of the functional form of agency cost, any additional allocation of resources by directors (directly) or managers (indirectly) on non-shareholder stakeholders will result in a negative impact on shareholders, such as a decrease in corporate transparency. There are three rationales as to why this could happen. First, there is a cost to providing higher quality information to shareholders. As resources are stretched thin by various stakeholder demands, there are fewer resources available to allocate to delivering the highest quality information to shareholders. Second, just as the board faces increasing demands from various stakeholders, so do managers. Rather than focusing just on one thing—something they have been trying to hone their managerial skills to do—managers now find they need an expanding set of skills and will be held accountable to a new set of ever-shifting standards. Because managers prefer to avoid critical examination of their decisions (Zeelenberg 1999), they may reduce transparency. Third, as board monitoring goes down in the face of myriad stakeholder demands, managerial entrenchment may increase and has long been connected to lower informational quality to investors (Bertrand and Mullainathan 2003; Francis et al. 2005). All three rationales suggest the same directionality empirically—that transparency should go down in the face of statutes that allow for the consideration of various stakeholder demands. Since the actual values of R_{st} are unobservable, we cannot check the marginal impact of an additional unit of resources spent on non-equity stakeholders on firm transparency. However, we can test how resource diversion (or even consideration of it) toward non-shareholder stakeholders might have an effect as well as how diverted resources might be allocated to other stakeholders.

Appendix C Alternative measures of impact on labor

| Variable | (1) SGA-to-Sales Ratio | (2) Log (EBITDA-to- Employee Ratio) | (3) Log (Sales to Employee Ratio) | (4) Labor Unionization |
|----------------------------------|------------------------------|---|---|------------------------------|
| <i>Statute</i> | 0.003 (0.004) | 0.026 (0.025) | 0.015 (0.016) | 2.027** (0.888) |
| <i>Control Share Law</i> | -0.007 (0.007) | -0.067** (0.027) | -0.030 (0.023) | 0.373 (0.783) |
| <i>Business Conditions Law</i> | 0.001 (0.005) | 0.020* (0.011) | 0.004 (0.016) | -1.756* (0.898) |
| <i>Fair Price Law</i> | 0.012* (0.007) | 0.004 (0.022) | -0.028 (0.020) | 0.392 (0.843) |
| <i>Poison Pill Law</i> | -0.001 (0.006) | -0.020 (0.023) | 0.013 (0.018) | 1.027* (0.585) |
| <i>ROA</i> | -0.653*** (0.025) | 7.488*** (0.057) | 0.783*** (0.032) | 0.181 (0.235) |
| <i>Leverage</i> | -0.077*** (0.012) | 0.087*** (0.014) | 0.275*** (0.042) | 0.026 (0.047) |
| <i>Firm Size</i> | -0.060*** (0.008) | 0.242*** (0.032) | 0.018 (0.020) | 0.181 (0.164) |
| <i>Institutional Ownership</i> | 0.052*** (0.006) | 0.204*** (0.012) | -0.191*** (0.012) | -0.189 (0.164) |
| Constant | 0.818*** (0.074) | 1.216*** (0.081) | 3.512*** (0.243) | 40.266*** (0.695) |
| Observations | 44,571 | 42,657 | 49,378 | 48,341 |
| R-squared | 0.898 | 0.902 | 0.895 | 0.960 |
| Firm Fixed Effects | Yes | Yes | Yes | Yes |
| Year Fixed Effects | Yes | Yes | Yes | Yes |
| Cluster (Incorporation State) | Yes | Yes | Yes | Yes |

^a This table shows the effect of constituency statutes on measures of labor expenditures, labor productivity, and labor unionization. In Model 1, the dependent variable is firm expenditures on labor measured as *SGA to Sales Ratio*. In Model 2 and Model 3, the dependent variables are measures of labor productivity—*Log of EBITDA to Employee Ratio* and *Log of Sales to Employee Ratio*. In Model 4, the dependent variable is labor response measured as *Labor Unionization*. All variables are as defined in Appendix A. Standard errors are reported in parentheses. ***, **, and * denote statistical significance at the two-tailed 1%, 5%, and 10% level, respectively.

Appendix D Alternative stakeholder impact measures

| | (1) Environmental Stewardship Concerns (KLD) | (2) Community Involvement Concerns (KLD) | (3) Employee Relations Concerns (KLD) | (4) Diversity Concerns (KLD) |
|--------------------------------|--|--|---|---------------------------------------|
| <i>Statute</i> | -0.092*** (0.029) | 0.033* (0.017) | 0.100** (0.047) | 0.100*** (0.025) |
| <i>Business Conditions Law</i> | -0.026** (0.010) | -0.054*** (0.014) | -0.040 (0.110) | 0.058*** (0.020) |
| <i>Poison Pill Law</i> | -0.023 (0.025) | -0.048** (0.023) | 0.023 (0.048) | -0.058 (0.044) |
| <i>ROA</i> | -0.017 (0.036) | 0.008 (0.017) | -0.224*** (0.046) | 0.081** (0.036) |
| <i>Leverage</i> | 0.050*** (0.007) | 0.010* (0.005) | -0.014 (0.008) | -0.023* (0.014) |
| <i>Firm Size</i> | 0.003 (0.019) | 0.016 (0.018) | 0.002 (0.041) | -0.022 (0.017) |
| <i>Institutional Ownership</i> | -0.059*** (0.015) | -0.033*** (0.009) | -0.146*** (0.012) | -0.026 (0.022) |
| Constant | -0.108* (0.057) | 0.052 (0.052) | 0.529*** (0.130) | 0.338*** (0.088) |
| Observations | 8,765 | 8,765 | 8,765 | 8,765 |
| R-squared | 0.849 | 0.637 | 0.612 | 0.648 |
| Firm Fixed Effects | Yes | Yes | Yes | Yes |
| Year Fixed Effects | Yes | Yes | Yes | Yes |
| Cluster (Incorporation State) | Yes | Yes | Yes | Yes |

^a This table shows the effect of constituency statutes on number of concerns of various stakeholders. In Model 1, the dependent variable is *Environmental Stewardship Concerns* measured as number of environmental related concerns in KLD database at firm-year level. In Model 2, the dependent variable is *Community Involvement Concerns* measured as number of community related concerns in KLD database at firm-year level. In Model 3, the dependent variable is *Employee Relations Concerns* measured as number of employee related concerns in KLD database at firm-year level. In Model 4, the dependent variable is *Diversity Concerns* measured as number of employee diversity related concerns in KLD database at firm-year level. All dependent variables are computed as the logarithm of one plus the number of concerns. All variables are as defined in Appendix A. Standard errors are reported in parentheses. ***, **, and * denote statistical significance at the two-tailed 1%, 5%, and 10% level, respectively.

Appendix E Anti-takeover laws

The five most common types of antitakeover laws adopted by U.S. states since 1982 are constituency statutes, control share law, business combinations law, fair price law, and poison pill law. All five laws are classified as second-generation anti-takeovers laws. For more details on first versus second-generation anti-takeover laws, refer to Karpoff and Wittry (2018). Because constituency statutes are covered in the body of the paper, this appendix summarizes the other four laws.

Control share law

Under this act, stockholders can limit the power of shares (“control shares”) whose acquisition would give the acquirer a certain specified amount of voting power in the election of directors of the corporation. The act applies each time an acquisition would provide the acquirer with any of three threshold levels of control: one-fifth of all voting power, one-third, and a majority. Unless a corporation’s articles of incorporation or bylaws say that the act does not apply, the shares in a control share acquisition have only those voting rights conferred upon them through a vote of the other (disinterested) shareholders at a meeting subsequent to the acquisition. We refer to Karpoff and Wittry (2018) to compute a dummy variable based on years in which states adopted this law.

Business combinations law

This law limits the transactions between publicly traded companies and their most prominent minority shareholders. Basically, a company may not merge or conduct other major transactions with a company owned by a minority shareholder for a certain number of years after the minority shareholder takes on a certain, defined percentage of the company’s equity. We refer to Karpoff and Wittry (2018) to compute a dummy variable based on years in which states adopted this law.

Fair price law

As per this law, the acquiring company must pay all shareholders the same amount per share in multi-tiered shares. The fair price provision exists both to protect shareholders and to discourage hostile acquisitions by making them more expensive. We refer to Karpoff and Wittry (2018) to compute the dummy variable based on years in which states adopted this law.

Poison pill law

The poison pill law functions in such a manner that if any bidder attempts to acquire a specific percentage of ownership in the firm, the ‘pill’ is triggered. When this happens, a massive number of shares are automatically issued by the company to each of the existing shareholders. The result is that the shares owned by the incoming bidder become diluted to the point that a controlling stake becomes impossible. We refer to Karpoff and Wittry (2018) to compute a dummy variable based on years in which states adopted this law.

Online Appendix

Table 1A Alternative measures of entrenchment

| Variable | (1) EM(Jones) | (2) Log Compensation CEO | (3) Log Compensation Director |
|--------------------------------|----------------------|-----------------------------|----------------------------------|
| <i>Statute</i> | 0.052** (0.021) | 0.271*** (0.062) | 0.764*** (0.046) |
| <i>Control Share Law</i> | -0.002 (0.015) | | |
| <i>Business Conditions Law</i> | -0.007 (0.014) | | |
| <i>Fair Price Law</i> | -0.023 (0.016) | | |
| <i>Poison Pill Law</i> | 0.049** (0.023) | -0.099 (0.137) | -0.162** (0.066) |
| <i>ROA</i> | 0.306 (0.291) | 1.058*** (0.184) | -0.387* (0.210) |
| <i>Firm Size</i> | 0.082** (0.036) | 0.230** (0.112) | 0.184*** (0.043) |
| <i>Leverage</i> | 0.174** (0.073) | -0.360*** (0.074) | -0.040 (0.114) |
| <i>Institutional Ownership</i> | -0.105*** (0.036) | 0.578*** (0.132) | 0.259** (0.113) |
| Constant | -0.597*** (0.220) | 4.698*** (0.881) | 1.819*** (0.424) |
| Observations | 23,099 | 2,383 | 2,268 |
| R-squared | 0.168 | 0.704 | 0.683 |
| Firm Fixed Effects | Yes | Yes | Yes |
| Year Fixed Effects | Yes | Yes | Yes |
| Cluster (Incorp State) | Yes | Yes | Yes |

^a This table shows the impact of constituency statutes on an alternative measure of earnings management, and on compensation of CEO and board of directors with the matched sample based on nearest neighbor matching. The sample is the same as we used in Table 9, where we match firms using four covariates: Firm Size, ROA, Leverage, and Institutional Ownership. The alternative earnings management is measured using modified Jones model. All variables are as defined in Table 3. Standard errors are reported in parentheses. ***, **, and * denote statistical significance at the two-tailed 1%, 5%, and 10% level, respectively.

Table 2A Non-shareholder stakeholder interests and constituency statutes with matched sample

| | (1) | (2) | (3) | (4) |
|--------------------------------|----------------|--------------------|----------------|--------------|
| | Labor | Customers | Creditors | Shareholders |
| Variable | Labor Expenses | Customer Awareness | Coverage Ratio | PEG |
| <i>Statute</i> | 0.005 | 0.000 | -8.091 | -0.433** |
| | (0.005) | (0.001) | (5.017) | (0.206) |
| <i>Control Share Law</i> | -0.001 | -0.000 | -11.381 | 0.192 |
| | (0.007) | (0.001) | (7.576) | (0.207) |
| <i>Business Conditions Law</i> | -0.004 | 0.000 | -7.967 | -0.299* |
| | (0.006) | (0.001) | (5.456) | (0.159) |
| <i>Fair Price Law</i> | -0.001 | 0.000 | -0.185 | 0.242 |
| | (0.007) | (0.001) | (6.356) | (0.185) |
| <i>Poison Pill Law</i> | -0.009 | 0.000 | 3.264 | 0.007 |
| | (0.007) | (0.001) | (4.813) | (0.207) |
| <i>ROA</i> | -0.029*** | -0.001 | 67.697*** | -3.148*** |
| | (0.009) | (0.003) | (17.156) | (0.497) |
| <i>Leverage</i> | -0.025** | 0.004* | -73.633*** | -0.371 |
| | (0.010) | (0.002) | (8.759) | (0.399) |
| <i>Firm Size</i> | 0.011*** | -0.001*** | 7.524** | 0.184* |
| | (0.002) | (0.000) | (3.069) | (0.097) |
| <i>Institutional Ownership</i> | 0.009* | -0.000 | 37.490*** | 0.148 |
| | (0.005) | (0.001) | (8.157) | (0.682) |
| Constant | -0.028** | 0.019*** | -13.821 | 1.141** |
| | (0.012) | (0.002) | (21.216) | (0.566) |
| Observations | 23,620 | 23,620 | 21,703 | 12,418 |
| R-squared | 0.814 | 0.868 | 0.485 | 0.241 |
| Firm Fixed Effects | Yes | Yes | Yes | Yes |
| Year Fixed Effects | Yes | Yes | Yes | Yes |
| Cluster (Incorp State) | Yes | Yes | Yes | Yes |

^a This table shows the effect of constituency statutes on stakeholder welfare and shareholder interests with the matched sample based on nearest neighbor matching. The sample is the same as we used in Table 9, where we match firms using four covariates: Firm size, ROA, Leverage, and Institutional ownership. All variables are as defined in Table 3. Standard errors are reported in parentheses. ***, **, and * denote statistical significance at the two-tailed 1%, 5%, and 10% level, respectively.

Table 3A Institutional investors and constituency statutes

| Variable | (1) Pctg Change in number of Top 5 Institutional Holders | (2) Ratio of Block holders to Total Institutional Holders (Counts) | (3) Ratio of Block holders to Total Institutional Holders (Dollar Value) |
|--------------------------------|--|--|--|
| <i>Statute</i> | -0.014* (0.007) | -0.006** (0.003) | -0.016* (0.009) |
| <i>Control Share Law</i> | -0.012 (0.010) | 0.003 (0.004) | 0.003 (0.011) |
| <i>Business Conditions Law</i> | 0.010 (0.008) | -0.001 (0.003) | 0.017 (0.013) |
| <i>Fair Price Law</i> | -0.010 (0.009) | 0.003 (0.003) | -0.016 (0.013) |
| <i>Poison Pill Law</i> | 0.002 (0.006) | 0.002 (0.002) | 0.003 (0.006) |
| <i>ROA</i> | -0.186*** (0.020) | -0.047*** (0.010) | -0.218*** (0.029) |
| <i>Firm Size</i> | -0.095*** (0.007) | -0.013*** (0.001) | -0.069*** (0.006) |
| <i>Leverage</i> | 0.184*** (0.016) | 0.023*** (0.006) | 0.132*** (0.019) |
| Constant | 1.128*** (0.040) | 0.121*** (0.008) | 0.775*** (0.036) |
| Observations | 21,214 | 21,214 | 16,756 |
| R-squared | 0.821 | 0.621 | 0.623 |
| Firm Fixed Effects | Yes | Yes | Yes |
| Year Fixed Effects | Yes | Yes | Yes |
| Cluster (Incorp State) | Yes | Yes | Yes |

^a This table shows the effect of constituency statutes on number of institutional investors and their ownership with the matched sample based on nearest neighbor matching. The sample is the same as we used in Table 9, where we match firms using four covariates: Firm Size, ROA, Leverage, and Institutional Ownership. All variables are as defined in Table 3. Standard errors are reported in parentheses. ***, **, and * denote statistical significance at the two-tailed 1%, 5%, and 10% level, respectively.

Table 4A Alternative measures of impact on labor

| Variable | (1) SGA-to-Sales Ratio | (2) Log (EBITDA-to- Employee Ratio) | (3) Log (Sales to Employee Ratio) | (4) Labor Unionization |
|--------------------------------|------------------------------|---|---|------------------------------|
| <i>Statute</i> | 0.002 (0.003) | 0.014 (0.019) | 0.022 (0.016) | 1.324 (0.898) |
| <i>Control Share Law</i> | -0.003 (0.005) | -0.074*** (0.026) | -0.037* (0.021) | 0.022 (0.782) |
| <i>Business Conditions Law</i> | -0.001 (0.003) | 0.021 (0.014) | 0.013 (0.017) | -1.092 (0.862) |
| <i>Fair Price Law</i> | 0.005 (0.005) | 0.005 (0.023) | -0.014 (0.019) | 0.263 (0.774) |
| <i>Poison Pill Law</i> | 0.003 (0.004) | -0.021 (0.016) | 0.013 (0.015) | 1.379** (0.583) |
| <i>ROA</i> | -0.361*** (0.019) | 7.035*** (0.179) | 1.003*** (0.059) | 0.375 (0.378) |
| <i>Firm Size</i> | -0.020*** (0.003) | 0.072*** (0.018) | 0.124*** (0.020) | 0.001 (0.101) |
| <i>Leverage</i> | -0.009 (0.015) | 0.287*** (0.055) | -0.028 (0.026) | 0.159 (0.251) |
| <i>Institutional Ownership</i> | 0.007 (0.005) | 0.202*** (0.032) | -0.098*** (0.016) | -0.463 (0.319) |
| Constant | 0.417*** (0.023) | 1.273*** (0.085) | 4.209*** (0.128) | 40.195*** (0.751) |
| Observations | 21,454 | 22,528 | 23,626 | 22,787 |
| R-squared | 0.917 | 0.916 | 0.930 | 0.968 |
| Firm Fixed Effects | Yes | Yes | Yes | Yes |
| Year Fixed Effects | Yes | Yes | Yes | Yes |
| Cluster (Incorp State) | Yes | Yes | Yes | Yes |

^a This table shows the effect of constituency statutes on measures of expenditure on labor, labor productivity, and labor unionization with the matched sample based on nearest neighbor matching. The sample is the same as we used in Table 9, where we match firms using four covariates: Firm Size, ROA, Leverage, and Institutional Ownership. In Model 1, the dependent variable is firm expenditure on labor measured as *SGA to Sales Ratio*. In Model 2 and Model 3, the dependent variables are measures of labor productivity: *Log of EBITDA to Employee Ratio* and *Log of Sales to Employee Ratio*. In Model 4, the dependent variable is labor response measured as *Labor Unionization*. All variables are as defined in Table 3. Standard errors are reported in parentheses. ***, **, and * denote statistical significance at the two-tailed 1%, 5%, and 10% level, respectively.

Table 5A Alternative stakeholder impact measures

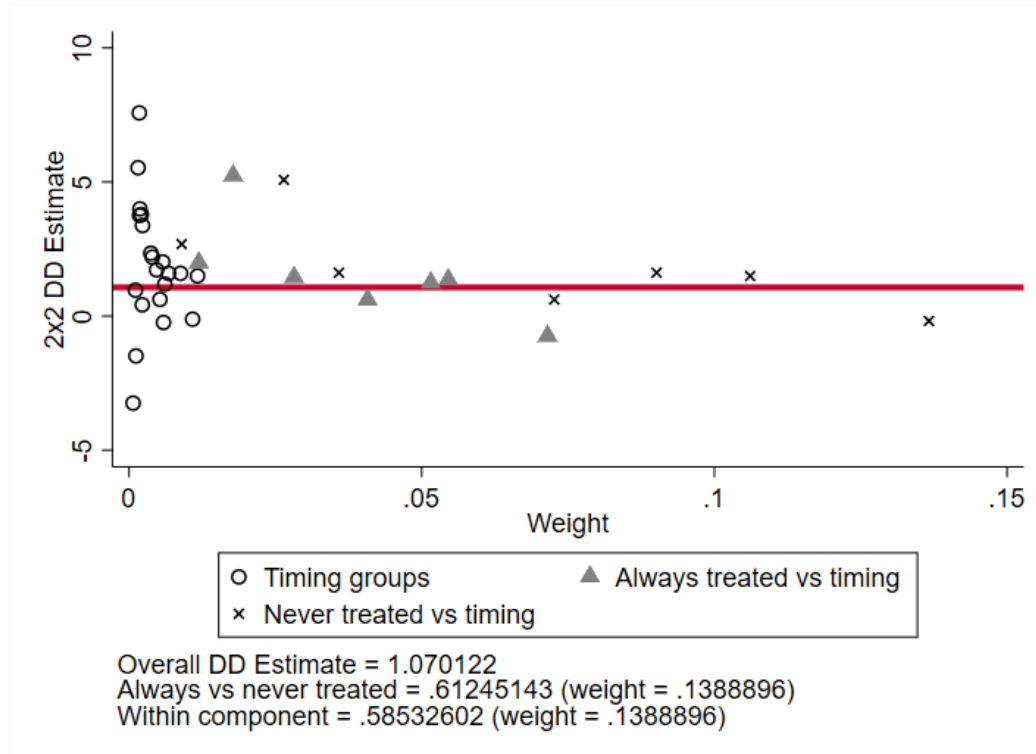
| Variable | (1) Environmental Stewardship Concerns (KLD) | (2) Community Involvement Concerns (KLD) | (3) Employee Relations Concerns (KLD) | (4) Diversity Concerns (KLD) |
|---------------------------------|---|---|--|---------------------------------------|
| <i>Statute</i> | -0.106*** (0.028) | 0.027 (0.016) | 0.091* (0.053) | 0.100*** (0.029) |
| <i>Business Conditional Law</i> | -0.043** (0.018) | -0.060*** (0.018) | -0.035 (0.104) | 0.036** (0.016) |
| <i>Poison Pill Law</i> | -0.011 (0.034) | -0.039 (0.024) | 0.038 (0.069) | -0.029 (0.035) |
| <i>ROA</i> | -0.032 (0.085) | 0.032 (0.046) | -0.385*** (0.109) | 0.049 (0.085) |
| <i>Firm Size</i> | 0.075*** (0.019) | 0.004 (0.012) | 0.002 (0.023) | -0.027 (0.031) |
| <i>Leverage</i> | 0.012 (0.042) | 0.018 (0.044) | -0.020 (0.075) | -0.054 (0.046) |
| <i>Institutional Ownership</i> | -0.114*** (0.033) | -0.029 (0.018) | -0.162*** (0.041) | -0.084* (0.049) |
| Constant | -0.205 (0.153) | 0.104 (0.131) | 0.416* (0.219) | 0.398* (0.233) |
| Observations | 3,994 | 3,994 | 3,994 | 3,994 |
| R-squared | 0.847 | 0.646 | 0.609 | 0.649 |
| Firm Fixed Effects | Yes | Yes | Yes | Yes |
| Year Fixed Effects | Yes | Yes | Yes | Yes |
| Cluster (Incorp State) | Yes | Yes | Yes | Yes |

^a This table shows the effect of constituency statutes on number of concerns of various stakeholders with the matched sample based on nearest neighbor matching. The sample is the same as we used in Table 9, where we match firms using four covariates: Firm size, ROA, Leverage, and Institutional ownership. In Model 1, the dependent variable is *Environmental Stewardship Concerns* measured as number of environmental related concerns in KLD database at firm-year level. In Model 2, the dependent variable is *Community Involvement Concerns* measured as number of community related concerns in KLD database at firm-year level. In Model 3, the dependent variable is *Employee Relations Concerns* measured as number of employee related concerns in KLD database at firm-year level. In Model 4, the dependent variable is *Diversity Concerns* measured as number of employee diversity related concerns in KLD database at firm-year level. All dependent variables are computed as the logarithm of the number of concerns plus one. All variables are as defined in Table 3. Standard errors are reported in parentheses. ***, **, and * denote statistical significance at the two-tailed 1%, 5%, and 10% level, respectively. Because the model specification includes firm-fixed effects, the dummy variables related to control share law and fair price law dropped in the regression analysis due to limited firm-level variation.

Table 6A Alternative Difference-in-Differences Estimators.

Panel A: Goodman-Bacon Method

Decomposition of DiD estimator



Multiple Group – Multiple Time ATT

| Variable | Coef. | Std. Err. | z | P>z | [95% Conf. Interval] |
|----------|-------|-----------|-------|-------|----------------------|
| Statute | 1.070 | 0.629 | 1.700 | 0.089 | -0.162 2.302 |

Panel B: Callaway and Sant'Anna Method

Group – Time ATT

The group-time average treatment effect of constituency statute on earnings management.

| | Coef. | Std. Err. | t | [95% Conf. Interval] |
|-----|-------|-----------|------|----------------------|
| ATT | 0.011 | 0.009 | 1.16 | -0.006 0.026 |

Panel C: Stacked Regression Method

| Variable | (1) Earnings Management |
|---------------------------------|-------------------------------|
| <i>Statute</i> | 0.571* (0.332) |
| <i>Control Share Law</i> | -0.155 (0.718) |
| <i>Business Conditional Law</i> | 0.126 (0.463) |
| <i>Fair Price Law</i> | 0.385 (0.580) |
| <i>Poison Pill Law</i> | 0.212 (0.279) |
| <i>ROA</i> | -11.699*** (1.610) |
| <i>Firm Size</i> | -0.929*** (0.195) |
| <i>Leverage</i> | 1.813** (0.836) |
| <i>Institutional Ownership</i> | -2.572*** (0.452) |
| Constant | 13.309*** (1.029) |
| Observations | 38,227 |
| Number of groups | 5,465 |
| Firm | Yes |
| Year | Yes |

^a This table shows the difference-in-difference (DiD) estimators based on Goodman-Bacon method, Callaway and Sant'Anna Method, and stacked regression. Panel A shows the DiD decomposition graph and regression results using Goodman Bacon method. Panel B shows regression results using Callaway and Sant'Anna Method. Panel C shows the regression results using stacked regression model. All variables are as defined in Table 3. Standard errors are reported in parentheses. ***, **, and * denote statistical significance at the two-tailed 1%, 5%, and 10% level, respectively.

Table 7A Constituency statutes and shareholder reaction

| Variable | Obs | Mean | Std. Err. | Std. Dev. | [95% Conf. | Interval] |
|------------|-----|--------|-----------|-----------|------------|-----------|
| CAR (-1,1) | 623 | -0.019 | 0.064 | 1.591 | -0.144 | 0.106 |
| CAR (-5,5) | 623 | -0.038 | 0.080 | 2.005 | -0.196 | 0.120 |

^a This table shows the shareholders reaction to the announcement of constituency statutes adoption. Sample has 653 unique events. However, 30 events were dropped due to a lack of returns observations in the estimation period. The computation is done using the market model with an estimation window from 240 days to 20 days before the event and generates the cumulative abnormal returns (CAR) for two event windows – short window (CAR(-1,1)) and long window (CAR(-5,5)).