Cost of Conscious Capitalism[±]

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ABSTRACT

Calls for conscious capitalism have spurred numerous innovations in firm governance. In this study, we assess whether there is a cost to investors for one such innovation—state-level constituency statutes that permit board members to consider the interests of all stakeholders—not just shareholders—when making decisions. As competing demands from stakeholders increase, we argue monitoring by boards will be hampered, resulting in reduced transparency to investors by managers. Using a sample of U.S. publicly traded firms (1981-2010), we observe significant decline in transparency by firms incorporated in states with such statutes. While we find firms experiencing losses use conscious capitalism as an umbrella to remain opaque, firms that need financial markets for capital remain transparent despite such statutes. Our paper contributes to the debate on the 'objective of the firm' by showing that adopting stakeholder governance without addressing its challenges may lead to managerial entrenchment and affect transparency negatively.

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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]) and corporate governance scholars (Bebchuk and Tallarita [2020]) has reinvigorated the decades' old debate between shareholder primacy (Berle [1932], Friedman [1970])—wherein directors and managers hold a fiduciary duty solely to protect shareholder interests—and what has alternatively been called stakeholder theory (Dodd Jr. [1932], Freeman [1984]), humanistic management (Pirson and Lawrence [2010], Amann, Pirson, Dierksmeier, Von Kimakowitz, and Spitzeck [2001]), and conscious capitalism (Mackey and Sisodia [2013], The Economist [2019])—wherein these same decision-makers are expected to take into consideration the impact of their decisions on various constituencies (hereafter, "conscious capitalism" for brevity). In this paper, we attempt to explore the cost of conscious capitalism for one of the important stakeholders – 'investors.' We provide evidence that by adopting the stakeholder perspective in business decision-making leads to managerial entrenchment and affects firm's transparency towards investors. This result is more prominent for loss making firms, but firms in need of capital from financial markets maintain transparency towards investors irrespective of statutes. We also find that interest coverage ratio and dividend yield reduced for such firms after adopting stakeholder perspective, implying a real cost of conscious capitalism to investors. These results are in line with arguments by Bhagat and Hubbard (2020) that without addressing theoretical and practical challenges regarding stakeholder governance, the lack of managerial accountability can become a problem.

As the corporate law community struggled with the legal implications of the fiduciary duties of managers and boards with respect to this debate (Mason [1959], Hansmann and Kraakman [2001], Stout [2002]), a legal safe harbor for boards of directors (Hill and Conaglen [2018]) began emerging on a state-by-state basis in the United States; so-called 'constituency statutes' allowed, but did not require, directors to take into consideration a broader group of stakeholders in their decision-making outside of just shareholders (Orts [1992-1993]). While various scholars pulled these statutes into their debates (Macey

[1991], Mitchell [1992], von Stange [1994]), the statutes themselves acted as an exogenous shock to the governance of the firms incorporated in the states where the statutes had been implemented. 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, Spivey, and Marr [1997]), constituency statutes have been shown to enhance value to shareholders in many ways—e.g., via smaller loan spreads (Gao, Li, and Ma [2020]), increased Tobin's Q (Cremers, Guernsey, and Sepe [2019]), and increased innovation (Flammer and Kacperczyk [2015]), while at the same time benefiting stakeholders—e.g., via greater board representation (Luoma and Goodstein [1999]) and increased corporate social responsibility (CSR) activity (Flammer [2015]).

Still, 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 (see 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 explored the duties of firms in terms of helping society to confront political power disparities and deeply entrenched societal-wide problems, such as wealth inequality and climate change.

The purpose of this paper is to explore what costs might exist when the interests of various constituencies create tradeoffs between them. Given that decision-making is fueled by information, we focus our attention on the degree and reliability of information flowing from firms to one particular stakeholder—shareholders—that prior scholars have argued would suffer as a result of divided attention across numerous and conflicting stakeholders. Existing studies have suggested that discretionary disclosure decisions are a function of conflicting incentives vis-à-vis multiple audiences (Bhojraj, Blacconiere, and D'Souza [2004]). We argue that including all stakeholders in the firm framework will squeeze the resources (including effort and/or time) of the board of directors to monitor managers, which will aggravate agency problems highlighted by prior scholars along the way (Jensen and Meckling [1976], Macey [1991], Rogers [1994]). We theorize this may reduce the firm's accountability towards investors (Macey [1991], Romano [1993]), decreasing transparency by firms incorporated in states where constituency statutes have been implemented. We test our theory using 60,365 firm-year observations from 1981 (three years before the states first started enacting constituency statutes in 1984) to 2010 (three years after the last constituency statute was enacted in 2007). Because transparency is best understood and measured in the context of the quality of corporate disclosure and reporting to shareholders (Hermalin and Weisbach [2007], Hermalin and Weisbach [2012]), we follow Hutton, Marcus, and Tehranian [2009] in measuring the increase in earnings management as a proxy for a decline in reporting quality or reduced corporate transparency. Our results accord with prior work suggesting a cost of taking into account stakeholder interests (Liu, Liu, and Reid [2019]), but differ directionally from other work (e.g., Gao et al. [2020]).

There are three reasons why the study of constituency statutes is appealing from an empirical standpoint. First, corporate behavior is generally driven by the law of the state of incorporation, and not by the law of the state where a corporation is headquartered and principally conducts its business. Because the state of incorporation and the headquarters state are frequently different, it is possible to examine the impact of the adoption of constituency statutes independent of changes in local economic conditions in the state where the corporation is headquartered and principally doing business. Second, because constituency statutes are not enacted with the specific intent of impacting corporate transparency, but rather to impact

the types of stakeholders' corporate decision-makers might consider, any observed impact on corporate transparency is an unintended consequence of the legislation. Third, the fact that constituency statutes are adopted by specific states at different points in time allows us to study the impact using a difference-in-difference framework. This allows us to avoid the common identification difficulty faced by studies with a single shock (Roberts and Whited [2013]).

Our results show that as constituency statutes opened the door for directors (directly) and managers (indirectly) to take into account various stakeholder interests, corporate transparency actually went down. Using various proxies of corporate transparency—earnings management, 10-K readability, analyst coverage/accuracy, and institutional investor holdings—we find that constituency statutes are positively related to lower transparency to shareholders. These results are particularly pronounced for large firms, those with low financial constraints, those with low growth, and those with high institutional investor holdings. This implies that transparency of firms that need to access financial markets for capital—such as small firms, high growth firms, high financial constraint firms, or low institutional investor holdings firms—is either not affected or increased even if those firms are incorporated in states with such statutes. Furthermore, we show that firms going through losses use conscious capitalism as an umbrella to remain opaque. We also demonstrate that our findings are robust vis-à-vis a change in the state of incorporation after the enactment of a constituency statute. In short, we document a cost of conscious capitalism that is borne by one particular stakeholder—shareholders—in the face of constituency statutes. In this way, our study contributes to the century-long debate between shareholder primacy and stakeholder orientation / humanistic management / conscious capitalism by examining the question of whether and how corporate transparency is impacted by changes in corporate governance resulting from the adoption of such statutes.

Section 2 provides a theoretical framework to show how including all stakeholders in business decision making affects firm transparency. Section 3 lays out the institutional details on constituency statutes and their adoption. Section 4 explains the hypotheses and their development. Section 5 provides the details on data and empirical specification. Section 6 discusses the results and Section 7 concludes.

2. THEORETICAL MODEL

To show theoretically how the adoption of conscious capitalism (or stakeholder governance) might leads to managerial entrenchment and affect corporate transparency, we build a single period first order model in which directors have finite resources (e.g., budget, time, attention) to monitor the manager and by adopting the stakeholder governance, these resources would bifurcate in monitoring the manager and in resolving the issues of other stakeholders. . We theorize that the weakening in monitoring by the board aggravate the moral hazard problem and this would reflect in firm transparency to the investors. This is in align with Bhagat and Hubbard (2020) which argues that under stakeholder paradigm, almost any managerial issue, short of outright fraud, can be justified as consistent with addressing the priorities of some stakeholder group. Hence, the lack of managerial accountability becomes a problem.

We should note that we are not the first to discuss resources limits in terms of effort and time of directors; footnote 9 in the classic treatise on agency costs, Jensen and Meckling [1976], reflects precisely on this issue, 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:

Agency cost = Monitoring expenditure by the principal + Bonding expenditure by the agent + 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.

We theorize that the level of resources that can be dedicated to the consideration of shareholder concerns will decline as resources come to be allocated to consideration of other stakeholders. Figure 1 provides the intuition on how the adoption of conscious capitalism (or stakeholder orientation) leads to agency problems due to divergence in directors' resources and due to an increase in managerial discretion and how this hampers transparency towards shareholders.

[Insert Figure 1 Here]

Because constituency statutes directly articulate the 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 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 (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:

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

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:

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

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

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

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) on non-shareholder stakeholders will result in increase in managerial entrenchment and in decrease in corporate transparency. 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 whether resource diversion (or even consideration of it) toward non-shareholder stakeholders might have an effect on transparency.

3. INSTITUTIONAL BACKGROUND

Decades of literature in finance and accounting confirms the fact 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). This firm-specific information reaches investors mainly through three channels—corporate reporting, private information acquisition, and information dissemination (Bushman, Piotroski, and Smith [2004]). 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, Konchitchki, and Landsman [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, Schoorman, and Donaldson [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, Dagupta, and Sen [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 power to management to deviate from performing its traditional fiduciary duties toward shareholders to take into consideration other non-shareholder constituents (e.g., creditors, employees, customers). 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 2).

[**Insert Figure 2 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, three 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, Houston, and Naranjo [2014]). Third, 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 managers and directors—to set aside shareholder concerns for transparency. While shareholder primacy requires managers to be solely attentive to the needs of one constituency (i.e., equity holders), a conscious capitalism perspective allows corporate attention to be distributed across various constituencies with highly divergent interests, ranging from employees to shareholders, to community members. Just as Rogers [1994] worried that enactment of constituency statutes would result in diminished attention to shareholder concerns, we theorize that as competing stakeholders begin to make demands of corporate decision-makers in the wake of constituency statutes, those decision-makers will attempt to reduce the possibility of being held accountable—by reducing transparency

altogether. Put simply, the level of resources dedicated to consideration of shareholder concerns is anticipated to decline as resources are allocated to consideration of other stakeholders.

4. 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) as well as 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, Rajgopal, and Venkatachalam [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, Brown, and Sikes [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 an exogenous change in governance) by allowing managerial discretion to depart from shareholder concerns, and second (through an endogenous change in governance) by altering the monitoring of managers by the board.

At the same time, corporate decision-makers (be they directors or managers) prefer to avoid or deflect a critical examination of their decisions (Zeelenberg [1999]). Jensen [2006] argued the expectation that actors may be called on to explain or justify behavior can motivate them to act to protect themselves from accountability demands. We posit that the threat of these demands is what drives both directors (directly) and managers (indirectly) to become less transparent in the face of constituency statutes, which allow these decision-makers to divide resources, attention, time, etc. across different constituencies, but

may stretch their confidence in defending their decisions to the various constituencies. In other words, in the face of demands from myriad stakeholders, decision-makers will not be enjoying a 'quiet life' (Bertrand and Mullainathan [2003], Armstrong, Balakrishnan, and Cohen [2012]).

Substantial research shows that various professionals, ranging from CEOs to IRS agents, have a finite capacity to take in information and process it fully. Ocasio [1997] argued that managers cannot possibly take in all information into their decision-making, so they tend to focus on certain dimensions and ignore others. Cole and Chandler [2019] make similar attention-based arguments for CEOs, journalists, and corporate customers, while Drake, Jennings, Roulstone, and Thornock [2016] do the same for investors. Bozanic, Hoopes, Thornock, and Williams [2017] have shown how changes in SEC disclosure requirements alter what IRS agents pay attention to with respect to corporate taxation. Similar limitations have also been documented in boards of directors as well. After analyzing hundreds of board meeting transcripts, Tuggle, Sirmon, Reutzel, and Bierman [2010] found that board members selectively allocate attention to their monitoring function in ways that are contextually dependent. Renjie and Verwijmeren [2019] also find that board monitoring intensity goes down when directors become distracted by exogenous shocks in unrelated industries in which they hold other directorships.

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 managers and directors, 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 accountability demands will lead to the decision of managers and directors to release less information to the market in states that adopt constituency statutes. 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.

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). Jensen and Meckling [1976: 308] also 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." It is these possible trade-offs that define both agency costs and attention-based views. 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 theorize this will reduce the firm's accountability towards shareholders in discernable ways (Macey [1991], Romano [1993]).

Hypothesis 1 (H1). *Firms incorporated in a state with a constituency statute will reduce transparency to shareholders more than firms incorporated elsewhere.*

The literature documents numerous other ways that discretion can be exploited to impact the relative level of transparency to shareholders. Managers often add explanations to their earnings forecasts, linking them with internal actions (Baginkski, Hassell, and Kimbrough [2004]). Managers also may try to reduce the information processing costs of market participants by availing themselves of various tools (Blankespoor [2019]) and/or dissemination channels (Blankespoor, Miller, and White [2014]). And managers may increase voluntary disclosures to mitigate the challenges posed by complex financial accounting disclosures on market participants (Guay, Samuels, and Taylor [2016]).

At the same time, when desired, those same managers can elect to obfuscate information by manipulating various dimensions of disclosures themselves. Managers may play with the timing of disclosures (Aboody and Kasznik [2000]), such as disclosing bad news after the market has closed (deHaan, Shevlin, and Thornock [2015]) or contemporaneously releasing good news to offset bad news (Graffin, Carpenter, and Boivie [2011]). Managers also can make the actual content of the disclosures more complex

(Miller [2010]) or less readable (Li [2008]). They can even play with the tone of the disclosures (Loughran and McDonald [2013]).

The relative readability of disclosures has been connected to firm performance (Subramanian, Insley, and Blackwell [1993]) and auditing costs (Abernathy, Guo, Kubick, and Masli [2019]), so the discretion exercised appears salient in communicating something about the firm's underlying quality. As an example, good performers use stronger writing in their disclosures than poor performers (Subramanian et al. [1993]) and IPOs with high levels of uncertain text have higher first-day returns, absolute offer price revisions, and subsequent volatility (Loughran and McDonald [2013]). If, as we argued earlier, managers and/or directors hope to avoid accountability to shareholders, then we should see the relative accessibility of disclosures to decrease in the face of constituency statutes. We theorize this will result in reduced readability of financial statements in firms incorporated in states that implement constituency statutes.

Hypothesis 2 (H2). *Firms incorporated in a state with a constituency statute will reduce the readability of their financial statements than firms incorporated elsewhere.*

One factor known to have a strong effect on earnings management is financial analysts (Yu [2008]). Firms followed by more analysts, more experienced analysts, and analysts from top firms engage in substantially less earnings management than other firms (Yu [2008]). This can be attributed most likely to the role that analysts play in reducing information asymmetry in the market. Analysts provide earnings forecasts to shareholders (Libby and Tan [1999]), which are more accurate when accompanied by cash flow forecasts (Call, Chen, and Tong [2009]). Analysts also act as interpreters of complex financial accounting information (Chen, Cheng, and Lo [2010]).

For their part, firms benefit tremendously from analyst coverage. Firms with high disclosure quality ratings from financial analysts observe a lower effective interest cost of issuing debt (Sengupta [1998]). Firms covered by fewer analysts are less likely to issue equity as opposed to debt and must depend on more favorable market conditions when they do, which is often in larger amounts to exploit those rare windows (Chang, Dasgupta, and Hilary [2006]). Analysts also push firms toward more efficient investments related

to innovation, increasing the novelty of future innovation and future patenting activity (Guo, Pérez-Castrillo, and Toldrà-Simats [2019]).

Yet, despite the foundational role that analysts now hold in financial markets, analysts can be quite fickle. First, there is ample evidence that analysts regularly engage in herding behavior with other analysts (Booth, Chang, and Zhou [2014]), often based on very little information (Welch [2000]). Analysts that initiate coverage of a firm during such herding are more likely to overestimate the firm's future profitability as well as to abandon coverage of the firm later on (Rao, Greve, and Davis [2001]). As an extreme example, at the height of the market bubble in March 2000, analyst herding behavior and hyper-optimism resulted in ninety-two "buy" recommendations for every one "sell" recommendation (Hirsch and Pozner [2005]). Second, analysts have been observed engaging in overt actions to try to stand out from competitors and gain status in the field (Bowers, Greve, and Mitsuhashi [2017]). Other research shows that there is a stronger market reaction to the recommendations of leading analysts compared to followers (Booth et al. [2014]). Third, analysts can be strongly influenced by their access to managers (Westphal and Clement [2008]) and by other members of their own organization (Hayward and Boeker [1998]), both of which create an incentive for analysts to provide more rosy assessments of the firms they cover.

With this background, we theorize that the attraction for an analyst to cover a firm will go down when constituency statutes allow managers and directors the opportunity to begin prioritizing broader stakeholder concerns over narrower shareholder concerns. Our theory is anchored in two arguments. First, we know from prior work that Wall Street analysts who excel at handling non-diversified firms often become overwhelmed when covering more diversified firms (Zuckerman [1999]). Similarly, the shift in mentality required to set aside a shareholder maximization mindset when evaluating firms and begin to evaluate a multi-stakeholder mindset should be cognitively taxing for analysts. Second, prior research shows that even the most skilled Wall Street analysts experience a substantial drop in performance for several years just when moving into other groups at other firms (Groysberg, Lee, and Nanda [2008]), even when covering the exact same firms as in their previous position. If the 'shock' of simply changing one's employer is that cognitively challenging for an analyst, then the 'shock' of a completely new way of

assessing and interpreting corporate activity should be at least as challenging. We theorize that this should push analysts to want to drop coverage of firms in the face of constituency statutes and could reduce the accuracy of their forecasts.

Hypothesis 3 (H3). *Firms incorporated in a state with a constituency statute will experience reduced coverage by financial analysts and analyst report accuracy compared to firms incorporated elsewhere.*

Building on our logic that the enactment of constituency statutes will reduce the attraction for financial analysts to provide research coverage for firms in states with constituency statutes, we also theorize that a similar logic will extend to institutional investors' interest in those same firms as well. Scholars of governance have long argued that the presence of institutional investors can markedly alter the way managers steward their firms. Over the years, institutional investors have become more active in monitoring firm management and attempting to influence managerial decisions (Crutchley, Hudson, and Jensen [1998]). As one example, nearly three-fourths of firms that are targeted by the massive California Public Employees' Retirement System (CalPERS) adopt changes proposed by the institutional investor or make 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 decline (Bushee [1998]). The impact of institutional investors flexing their muscles can have a profound effect, especially when the other shareholders are widely dispersed, which would impede the ability of shareholders to act collectively (Anson, White, Ho, and CalPERS [2003]).

Importantly for our theory, when institutional investors hold just an investment stake (rather than direct business ties), they tend to influence CEO compensation in accordance with the shareholder primacy perspective (i.e., lowering overall salary level and increasing the proportion of long-term incentives; Parthiban, Kochhar, and Levitas [1998]). Thus, the primary reason why we theorize that constituency

statutes will impact the holdings of institutional investors is that such statutes undermine the ability of institutional investors to influence or coerce. Once constituency statutes are on the books, managers can always point to the concrete law that allows them to set aside shareholder concerns. We expect that the curtailed ability to influence managerial decision-making in constituency statute states will drive institutional investors away from firms incorporated in those states.

Hypothesis 4 (H4). *Firms incorporated in a state with a constituency statute will experience reduced ownership by institutional investors compared to firms incorporated elsewhere.*

5. 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 60,365 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.

5.1. Dependent Variables

Earnings Management

We measure the level of earnings management using the Hutton et al. [2009] method. The measure is based on the idea that changes in a firm's accruals are primarily determined by changes in firm fundamentals, proxied by changes in revenues, and property, plant, and equipment. Higher deviations represent the lower quality of accruals and earnings.

To determine abnormal accruals, we employ the modified Jones model (Dechow, Sloan, and Sweeney [1996]) and estimate the following regression for each Fama and French industry for each year between 1981 and 2010:

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

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] show 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. Hutton et al. [2009] use these findings and develop a simple measure of opacity in financial reports as the three-year moving sum of the absolute value of annual discretionary accruals. We use this measure as earnings management and can be computed as we treat the firm-specific residual, $\varepsilon_{i,t}$, as abnormal accruals and use the three-year moving sum of the absolute value of the residual as the proxy for inverse earnings quality:

$$\text{Earnings Management} = \text{AbsV}(\varepsilon_{i,t-1}) + \text{AbsV}(\varepsilon_{i,t-2}) + \text{AbsV}(\varepsilon_{i,t-3}),$$

where $\text{AbsV}(\varepsilon_{i,t-1})$, $\text{AbsV}(\varepsilon_{i,t-2})$, and $\text{AbsV}(\varepsilon_{i,t-3})$ are absolute values of firm-specific residual, ε_i, at t-1, t-2 and t-3.

Disclosure Readability

Our 10-K readability measure is captured through the Bog index (Bonsall IV, Leone, Miller, and Rennekamp [2017]). The Bog Index is a comprehensive measure of readability designed to capture writing features that "bog" readers down. Based on plain English attributes similar to those highlighted by the SEC's *Plain English Handbook* (1998), the Bog Index formula is comprised of three components:

$$\text{Bog Index} = \text{Sentence Bog} + \text{Word Bog} - \text{Pep},$$

where a higher Bog Index equates to a less readable document. Sentence Bog identifies readability issues

stemming from sentence length. Word Bog incorporates multiple plain English style problems (e.g., passive verbs) and word difficulty. Pep counts the features in the document that are essential for good writing.[1]

Analyst Coverage, Analyst Accuracy

Analyst coverage is calculated as the number of analysts following a firm. Analyst accuracy is measured as an absolute value of the difference between mean analyst forecast and actual earnings per share scales by actual earnings (Call et al. [2009]).

Institutional Investor Holdings

Institutional investor holdings is defined as the percentage of outstanding shares owned by institutional investors.

Coverage Ratio

Coverage ratio is earnings before interest and tax scaled by interest expense.

Dividend Payout

Dividend payout is dividend payments scaled by net income.

Dividend Yield

Dividend yield is the ratio of dividend per share to the stock price per share.

Robustness Measures

For robustness checks of changes in transparency due to constituency statutes, we use three real earnings management variables: abnormal cash flows, abnormal discretionary expenses, and abnormal production cost covered in cash flows, as developed by Roychowdhury [2006].

5.2. Independent Variable

Constituency Statutes

We use the enactment of constituency statutes as an exogenous shock to examine the impact of stakeholder orientation on corporate transparency. *Statute* is an indicator variable that equals one in the

[1] For more details on bog index, kindly refer Bonsall et al. [2017].

effective year and afterwards for all firms incorporated in the adopted states, and 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]).

5.3. 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. Further, according to Karpoff and Wittry [2018], we include other antitakeover laws to mitigate omitted variable bias. We also include dummies for four other common antitakeover laws identified by Karpoff and Wittry [2018]: *Business Combination Law, Control Share Law, Fair Price Law,* and *Poison Pill Law* (see Appendix A2 for an explanation of these laws). Definitions of all variables are included in Appendix 3.

5.4. Descriptive Summary

Table 1 Panel A shows the distribution of observations by state of incorporation of the firms. Most observations are concentrated in Delaware but, excluding Delaware, are found in New York, Ohio, Florida, and Pennsylvania. Panel B shows the yearly distribution of the observations; note that observations are approximately evenly distributed over the years. Panel C of Table 1 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 0.071 with standard deviation of 0.125, which is similar to Hutton et al. [2009]. Firm size has mean 5.766 and standard deviation of 1.827. Leverage ratio is 0.230 on average with standard deviation of 0.210. The mean value of ROA is 0.094 and the standard deviation is 0.180. The mean value of institutional ownership is 0.450 and the standard deviation is 0.275.

[Insert Table 1 About Here]

5.5. Empirical Specification

To examine whether a firm's stakeholder orientation reduces corporate transparency, we use staggered state level adoption of constituency statutes as a exogenous shock. The adoption of constituency statues can resolve the endogeneity problem as passed by states and are not endogenously driven by firm-specific conditions. We use the difference-in-difference specification suggested in Bertrand and Mullainathan (2003) (see page 1057). [2] The regression specification is as follows:

$$Trans_{i,t} = \alpha + \beta_1 Statute_{i,t} + \beta_2 L_t + \beta_3 X_{i,t} + \gamma_{firm} + \gamma_{year} + \gamma_{state-incorp} + \varepsilon_{i,t},$$

where transparency (*Trans*) is the main dependent variable, measured as earnings management, analyst coverage, analyst accuracy, 10-K readability (Bog Index), or institutional investor holdings. The dummy variable based on constituency statutes *(Statute*) is the main independent variable, which takes value 1 if a firm is incorporated in the state that adopted a constituency statute and year is after the adoption year. *L* is a vector of dummies for various anti-takeover laws including Business Combination Law, Control Share Law, Fair Price Law, and Poison Pill Law. *X* is a vector of firm fundamentals such as ROA, leverage, firm size, and percentage of institutional ownership (proxy of governance). β_1 is the coefficient of interest and it compares the corporate transparency of firms in states that enacted statutes versus firms in states that have not.

Finally, in terms of specification, we include firm, year, and incorporation state fixed effects to mitigate the impact of unobservable factors. We believe that our empirical specification provides a strong identification strategy; not controlling for year and incorporation state fixed effects (e.g., Gao et al. [2020], Armstrong et al. [2012]) 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

[2] Although Bertrand and Mullainathan [2003] use the incorporation fixed effects as additional control only for plant level analysis but as plant can be shifted to other state of incorporation so does the firm (Bebchuk and Cohen [2003]).

when compared to alternative specifications.[3] To account for serial correlation due to the error term, we also cluster standard errors by the state of incorporation.

Table 2 shows the regression results for the impact of constituency statutes on earnings management. The regression results demonstrate that the coefficient of *Statute* is positive and significant at 1% for the baseline scenario, and remains positive and statistically significant after controlling for other most common antitakeover laws and firm characteristics. The *Statute* coefficient value of 0.006 implies that earnings management increased for firms incorporated in states that enacted constituency statutes. If we want to understand the magnitude of the change, then the coefficient of 0.006 equates to roughly 8.45% (i.e., 0.006/0.071) of the mean earnings management of our sample. These results support Hypothesis 1. As a reference, in a recently published paper that uses the exact same measure of discretionary accruals, Beuselinck, Cascino, Deloof, and Vanstraelen [2019] find 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.

Coefficients for *Control Share Law, Business Conditions Law, Fair Price Law,* and *Poison Pill* are generally not statistically significant, suggesting that these laws had little or no effect on earnings management. *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 Investor Holdings* is negatively related to earnings management but not significantly different from zero.

[Insert Table 2 About Here]

Table 3 captures the relationship between constituency statutes and disclosure readability. We use the Bog index (Bonsall IV et al. [2017]) to measure 10-K readability; if the Bog index is high, it indicates

[3] 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. The result table is provided in Appendix A1.

that a 10-K report is more difficult to decipher (i.e., less transparent). The coefficient for *Statute* in the fully specified 10-K readability regression (Table 3, Column 4) is 0.879 and statistically significant at 5%, suggesting that firms incorporated in states with constituency statutes exhibit lower levels of readability in 10-K reporting. This confirms Hypothesis 2 and lends support to our overall supposition that constituency statutes lead to lower levels of transparency for shareholders.

[Insert Table 3 About Here]

Table 4 captures the relationship between constituency statutes and analyst coverage. Analyst coverage decreased among the firms incorporated in states that adopted constituency statutes, evidenced by the negative coefficient for *Statute*, but the results do not hold in the presence of the myriad controls. In Table 5, we also explore the effect of constituency statutes on analyst accuracy, which measures the absolute difference between the analyst's forecast of earnings and actual earnings for the year. High value of analyst accuracy means more accurate forecasted earnings among the analysts following the same firm. As shown in Table 5, the coefficient for *Statute* is negative and statistically significant at the 1% level, suggesting that firms adopt constituency statutes impose greater forecasting difficulty on analysts. This could be due to the inability of analysts to understand how resource allocation to non-shareholder stakeholders will affect firm performance, or that financial performance is becoming less transparent in the face of constituency statutes—both possibilities document a clear 'cost' of conscious capitalism for investors who rely on analyst guidance.

[Insert Table 4 and Table 5 About Here]

Table 6 shows how the adoption of constituency statutes has affected the governance of firms, as proxied by institutional ownership percentage.[4] We find that for firms going through losses, being incorporated in the state which adopted constituency statutes affected governance negatively and statistically significantly. We do not find any impact of statutes on institutional ownership (governance proxy) for profitable firms.

[4] Because board characteristics such as board size, board diversity, or gender diversity is unavailable from the 1980s, we use the percentage of institutional ownership as a proxy of governance.

[Insert Table 6 About Here]

In Table 7, we explore differentiated effects of constituency statutes on corporate transparency based on the firm size, financial constraints, growth opportunities, and governance. Column 1 confirms that large firms normally have low earnings management as compared to small firms (Berger and Udell [1995], Brav [2009]) which is captured in the -0.021 coefficient with the significance at 1% level (*Large firm* represents firms with above-median size). However, large firms incorporated in states that adopted Constituency Statutes experience an increase in earnings management by 0.008 (the coefficient on *Statute* × *Large firm* interaction term) relative to large firms incorporated in non-CS states and small firms incorporated in CS states or non-CS states. This implies that although large firms still have lower earnings management compared to small firms, that tendency is affected by the adoption of constituency statutes.

In Column 2, we compare transparency results of firms with more financial constraints to those with fewer (Kaplan and Zingales [1997], Aghion, Van Reenen, and Zingales [2013]). We posit that firms facing a high degree of financial constraints are often in need of external funding and are, thus, incentivized to increase transparency in order to maximize access to those sources. In contrast, firms with fewer financial constraints have no such incentive. We theorize that, following the adoption of constituency statutes, firms with fewer financial constraints are more likely to exhibit decreased transparency compared to firms facing higher degrees of financial constraint. *High Constraint firm* is a dummy variable with value 1 for a KZ index above the median; otherwise 0. The index is based on the Lamont, Polk, and Saaá-Requejo [2001] five-factor model. Column 2 shows that firms with high constraints normally have higher earnings management as compared to firms with low constraints; the 0.005 coefficient is significant at 1% level. However, high financial constraints firms incorporated in states that adopted constituency statutes experience an increase (although not statistically significant) in earnings management (as suggested by positive 0.001 coefficient on *Statute* × *High Constraints firm* interaction term) relative to firms with high constraints incorporated in non-CS states and firms with low constraints incorporated in CS states or non-CS states.

In Column 3, we examine firms with high growth opportunities as compared to firms with low growth opportunities. High growth opportunity firms have increased financing needs compared to low growth firms (Gatchev, Spindt, and Tarhan [2009]). Thus, they are incentivized toward increased transparency in order to maximize access to funding sources (Khurana, Pereira, and Martin [2006]). We observe the same direction in our sample, where the coefficient for *High Growth firm* is -0.002; this suggests that high growth firms normally have more transparency compared to low growth firms. However, high growth firms incorporated in states that adopted constituency statutes experienced an increase in earnings management by 0.001 (*Statute* × *High Growth firm* interaction term) relative to high growth firms incorporated in non-CS states and low growth firms incorporated in CS states or non-CS states. This implies that high growth firms become more likely to engage in earnings management in states where constituency statutes are adopted. The results are not statistically significant, though.

Finally, in Column 4, since governance is the mechanism through which stakeholder orientation could affect a firm's transparency, we also examine the change in transparency for low governance firms versus high governance firms. Extant literature suggests that firms with weaker corporate governance regimes exhibit a higher level of earnings management than firms with strong corporate governance regimes (Xie, Davidson III, and DaDalt [2003], Bergstresser and Philippon [2006]). We, therefore, hypothesize that firms with relatively weaker governance regimes and incorporated in states that enact constituency statutes will exhibit a greater decline in corporate transparency than firms with stronger governance regimes. Firms characterized by low governance (defined as those below the median in terms of holdings by institutional investors) normally have higher earnings management as compared to firms characterized by high governance; we observe this difference in the 0.013 coefficient (*Low Governance firm*), and the effect is significant at 1% level. But low governance firms incorporated in states that adopted constituency statutes experience a decrease in earnings management of 0.007 (*Statute* × *Low Governance firm* interaction term) with significance at 1% level relative to low governance firms incorporated in non-CS states and high governance firms incorporated in CS states or non-CS states. This implies that although low governance firms still have higher earnings management than high governance firms, this tendency is affected by the

adoption of constituency statutes. This aligns with prior findings that adjustments costs are higher for firms with weak corporate governance (Liu et al. [2019]).

The lesson of these four models is that firms that are generally more transparent become less so in the presence of constituency statutes and that firms that are generally less transparent become more so in similar circumstances. These results support our argument that board members and managers engage in trade-offs when constituency statutes provide a vehicle for doing so. At the same time, we do observe an overall decrease in transparency. This supports the argument made by us and other scholars such as Macey [1991] that shareholders may be affected negatively by the introduction of constituency statutes.

[Insert Table 7 About Here]

6.1. Robustness Checks

In Table 8, we use real earnings management variables as the dependent variables to examine whether the impact of constituency statutes is limited to accrual management, or it also leads to the management of real earnings. In Table 9, we also test for potential self-selection bias in the state of incorporation and with respect to firm transparency. In Table 10, we exclude Delaware-incorporated firms from our sample. In Table 11, we examine the subset of firms that are headquartered in the same state as they are incorporated. In Table 12, we explore the dynamics of the treatment effect, comparing two years before the adoption year to two years after the adoption year.

Table 8 shows the results for alternative measures of corporate transparency. Out of three real earnings management variables—abnormal cash flows, abnormal discretionary expenses, and abnormal production cost covered in Roychowdhury [2006]—we observe only abnormal cash flows as significantly associated with constituency statutes (Column 1). The regression results demonstrate that abnormal cash flows increased for the firms incorporated in statute states. All regression results are robust after controlling for firm characteristics, firm fixed effects, year fixed effects, and incorporation state fixed effects.

[Insert Table 8 About Here]

Table 9 shows results regarding self-selection, as firms can self-select the state of incorporation to make use of constituency statutes. We use Jay Ritter's data on firms' incorporation year to remove the firms which were incorporated in the states after the adoption of constituency statutes and re-ran the regressions. Our results are consistent even after resolving this endogeneity issue.

[Insert Table 9 About Here]

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 60% of our sample are firms incorporated in Delaware), which might create some sort of empirical bias. To mitigate this concern, we removed the observations for firms incorporated in Delaware and conducted the regression 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 *Statute* is 0.007 and it is significant at the 1% level.

[Insert Table 10 About Here]

Next, we try to further resolve other possible econometric concerns. Following Flammer and Kacperczyk (2015), we also use year fixed effects, headquarter state-year fixed effects, firm fixed effects, and clustered errors at the incorporation level. However, if the headquarter-state and incorporation state are the same, the variables for *Statute* and headquarter state-year fixed effects would be highly correlated. To avoid this issue yet check the strength of our results, we excluded the observations from the sample if the incorporation state and headquarter state are the same. As shown in Table 11, our results are consistent under this specification, and we can infer that corporate transparency towards shareholders has reduced after the adoption of constituency statutes.

[Insert Table 11 About Here]

As there is a possibility that firms adopted constituency statutes before or after the actual year of adoption, therefore, we also assess the dynamics of the treatment effect. We show how the treatment variable (*Statute*) effects changed from two years before the year of adoption to two years after the adoption of constituency statutes. The results show that the coefficient of *Statute (-2)* and *Statute (-1)* is negative and insignificant, and the coefficients of *Statute*, *Statute (+1)*, and *Statute (+2)* are positive. However, only the

coefficient for *Statute* is statistically significant. These results imply that the immediate adoption of these statutes reduces transparency toward investors significantly. We do note that transparency improved slightly with time, but not to the level it was before the adoption of *Statute*. These dynamics are captured in Figure 3, which contrasts the dynamics for firms two years after the adoption of constituency statutes compared to two years before. As one can see, the plot of the coefficients from Table 12 clearly shows that earnings management changed direction from negative to positive after the adoption of constituency statutes, providing support for our hypothesis that a firm's transparency towards shareholders decreases after the adoption of the statutes.

[Insert Table 12, Figure 3 About Here]

Lastly, we examine the real cost of conscious capitalism to investors. Using interest coverage ratio, dividend payout ratio, and dividend yield as dependent variables, we show that following the adoption of constituency statutes, firms saw reduced interest coverage ratio and dividend yield. The first column of Table 13 shows the regression results of coverage ratio; the coefficient for *Statute* is negative and significant at the 10% level. The second column shows the regression results for dividend payout ratio; the coefficient for *Statute* is negative but insignificant. The last column shows the regression results of dividend yield; the coefficient for *Statute* is negative and significant at 10% level. Combined, these results show a real cost of conscious capitalism for investors beyond the transparency issues documented earlier.

[Insert Table 13 About Here]

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. However, our findings do differ directionally from other work, in particular work by Gao et al. [2020] and Armstrong et al. [2012]. Gao et al. [2020] argue that stakeholder orientation should reduce short-termism, which they hypothesize would lead to a decrease in earnings management. We point out that there are three key differences in data that can explain possible causes of these differences. First, our sample is roughly 2 times larger than Gao et al. [2020]—60,365 firm-year observations vs. 36,519 firm-year observations. Second, the Gao et al. [2020] sample starts from 1987 onwards and uses the statute adoption year (rather than effective year), which means they miss the effect

of constituency statutes in five states: Ohio, Illinois, Maine, Arizona and Missouri. Third, a close look at the descriptive statistics for firm size shows that Gao et al. [2020] may be characterized by "large firm bias"; the average total assets of firms in their sample is 8.372 million dollars, whereas ours is 2.414 million. Viewing these three pieces of data in combination, one can see that the Gao et al. [2020] paper features a substantially smaller sample of much larger firms than our sample. While smaller samples can provide important insights, we generally adhere to the principle that more exhaustive samples and those that avoid "large firm bias" can provide "better" and "more robust" insights than other samples. Turning to Armstrong et al. [2012], these authors find that the informativeness of financial statements released by firms (measured by decreased use of accruals) actually increased following the passage of antitakeover laws. They also find that the accuracy of analyst forecasts improved (while analyst coverage itself declined) in the face of these laws. Both findings are anchored in arguments that "antitakeover laws insulate managers from the threat of a takeover, which allows them to more easily pursue the 'quiet life'" (Armstrong et al. [2012: 190]); i.e., lower uncertainty about, and variability in, future cash flows allows managers to improve reporting quality and guidance to analysts (which improves accuracy). Despite the important empirical difference that Armstrong et al. [2012] are examining the impact of wide array of statutes (e.g., those affecting the cost of acquisitions (e.g., Assumption of Labor Contracts), managerial compensation (e.g., Golden Parachute Restrictions), and decision-making liability (Expanded Constituency Provision) whereas ours only focuses on one subset of those statutes, our results actually align with Armstrong et al. [2012]'s arguments despite what appears to be directionality differences. At heart, 'quiet life' arguments around predictability, stability and reduced uncertainty of revenues and costs are fundamentally 'agency cost' arguments—the need for monitoring goes down as information asymmetries between insiders and outsiders are reduced. Thus, when decision makers do not (or cannot) pursue the 'quiet life'—such as when demands for time, resources and attention from myriad stakeholders increase in the wake of constituency statutes—the firms they steward should <u>not</u> undergo financial reporting quality improvements. Moreover, analyst accuracy should degrade, as both managerial guidance becomes more difficult and analysts' own skills are tested in this new

environment of accountability and distributed resource allocation. Thus, our results showing a decrease in transparency and analyst accuracy align with 'quiet life' vs. 'non-quiet life' arguments.

7. CONCLUSION

Building on the staggered adoption of state-level constituency statutes across the United States, we argue that the introduction of such statutes may limit the resources (time, money, attention) of directors to monitor the manager and this can lead to managerial entrenchment and raises concerns for transparency towards investors. This happens because corporate decision-makers may shift their attention from solely being focused on just one audience (shareholders) to a broader array of audiences (various stakeholders), which increases accountability demands on those decision-makers who now may be less confident in their ability to defend their decisions. We theorize that these factors will converge into a tendency for firms incorporated in states with constituency statutes to reduce their overall transparency towards shareholders, and find evidence of this phenomenon with respect to several performance metrics, including earnings management, abnormal cash flows, readability of 10-Ks and analyst accuracy.

Our study contributes to the ongoing discussion of how shocks to governance regimes through new laws affect firm disclosures and shareholders' access to information. An important difference between our findings and prior findings in Reg FD settings (Bushee, Matsumoto, and Miller [2004]) is that availing oneself of constituency statutes is purely voluntary; still, their introduction at the state level is associated with lower levels of transparency at the firm level despite the opt-in nature of the legislation.

Our results align with findings that entrenched managers are associated with lower levels of transparency (Shleifer and Vishny, 1989; Hermalin and Weisbach, 2012). We should also note that just because something is bad for shareholders does not mean that it is bad for other stakeholders. If resources such as budgets, time, and attention truly are finite, then shareholder primacy means that all of those resources are directed toward just one constituency of the firm—shareholders. That leaves other potential constituencies—employees, suppliers, community, etc.—underrepresented in terms of resource allocation. This lack of representation is precisely what the architects of constituency statutes were attempting to

mitigate through legislation. While we do not examine what benefits non-shareholder constituencies may have gleaned from these statutes, prior work documents benefits in terms of innovation (Flammer and Kacperczyk [2015]) and long-term shareholder value (Kacperczyk [2009]). “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 towards current debate on ‘objective of firm’ by showing that adoption of stakeholder governance without addressing its challenges such as lack of managerial accountability can affect the investors negatively.

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Figure 1. Constituency Statutes and Corporate Transparency

This figure shows how the adoption of stakeholder orientation can lead to increase in agency problem as a result of an increase in managerial discretion and increased resource divergence to accommodate the interests of all stakeholders.

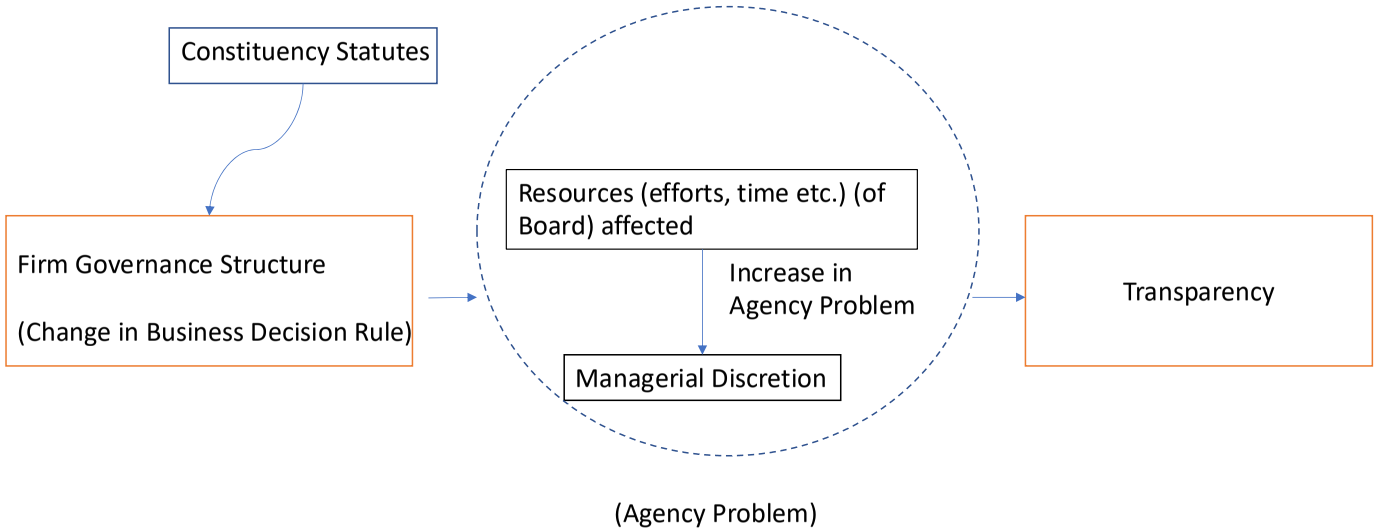

Figure 2. States' adoption of Constituency Statutes

This figure shows the states that adopted Constituency Statutes indicated by a darker color. Lighter color indicates the states that never adopted Constituency Statutes.

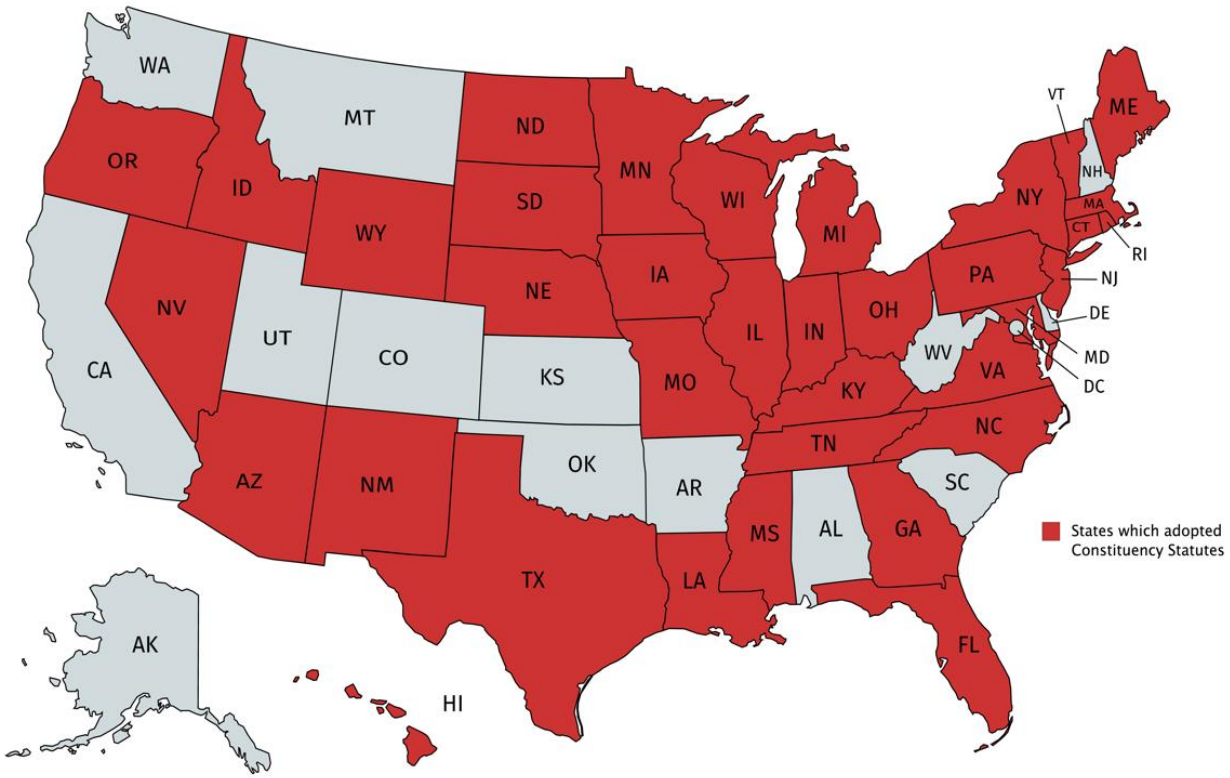

Figure 3

To show the dynamics of the relation between transparency and constituency statutes, this figure contrasts the dynamics for firms two years after the adoption of constituency statutes compared to two years before. As one can see, the plot of the coefficients from Table 10 clearly shows that earnings management changed direction from negative to positive after the adoption of constituency statutes, providing support for our hypothesis that a firm's transparency towards shareholders decreases after the adoption of said statutes.

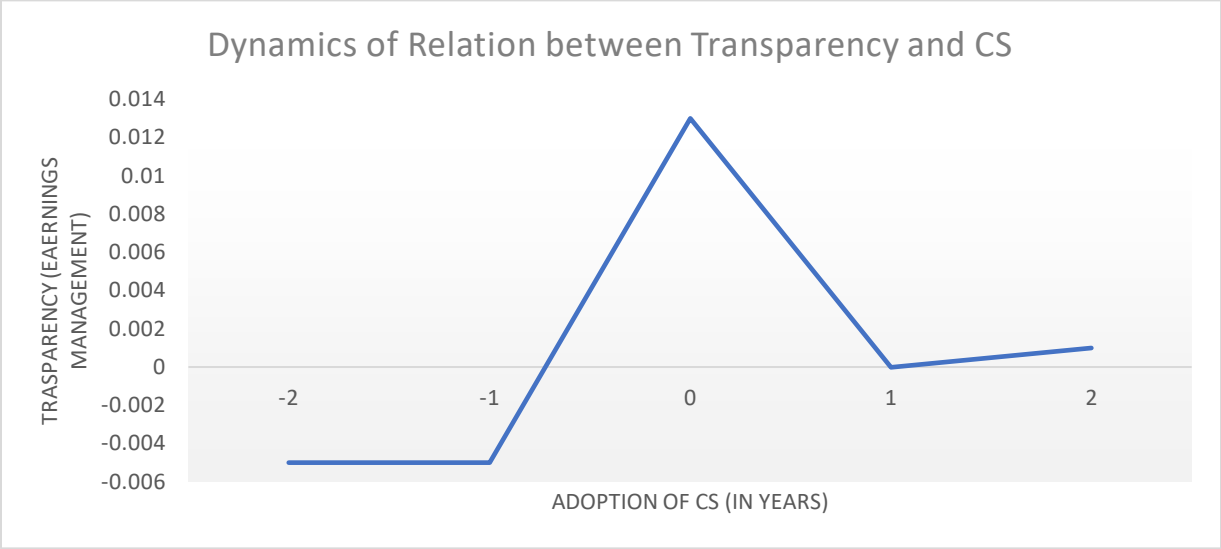

Table 1

Panel A: State-Level Data

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

	State-Level Constituency Statutes	Sample by State of Incorporation		
State	**Adoption Year**	**Freq.**	**Percent**	**Cum.**
Ohio	1984	1,588	2.63	88.47
Illinois	1985	293	0.49	68.1
Maine	1986	72	0.12	73.67
Arizona	1987	45	0.07	0.25
Minnesota	1987	1,541	2.55	77.39
New Mexico	1987	34	0.06	80.9
New York	1987	1,892	3.13	85.84
Wisconsin	1987	0	0	0
Idaho	1988	19	0.03	67.62
Louisiana	1988	202	0.33	69.97
Tennessee	1988	486	0.81	93.44
Virginia	1988	0	0	0
Florida	1989	1,106	1.83	65.9
Georgia	1989	792	1.31	67.22
Hawaii	1989	41	0.07	67.28
Indiana	1989	681	1.13	69.23
Iowa	1989	183	0.30	67.59
Kentucky	1989	118	0.2	69.63
Massachusetts	1989	1,474	2.44	72.41
Missouri	1989	438	0.73	78.12
New Jersey	1989	948	1.57	80.85
Oregon	1989	592	0.98	89.74
Mississippi	1990	57	0.09	78.21
Pennsylvania	1990	1,476	2.45	92.18
Rhode Island	1990	65	0.11	92.29
South Dakota	1990	69	0.11	92.63
Wyoming	1990	0	0	0
Nevada	1991	1,089	1.80	82.71
North Carolina	1993	526	0.87	79.12
North Dakota	1993	5	0.01	79.13
Connecticut	1997	242	0.40	4.15
Vermont	1998	0	0	0
Maryland	1999	686	1.14	73.55
Texas	2006	1,201	1.99	95.43
Nebraska	1988 (repealed in 1995), 2007	68	0.11	79.24
Alabama	n/a	103	0.17	0.17
Arizona	n/a	100	0.17	0.41
California	n/a	1,734	2.87	3.28
Colorado	n/a	280	0.46	3.75
District of Columbia	n/a	16	0.03	4.17
Delaware	n/a	36,157	59.9	64.07
Kansas	n/a	124	0.21	69.44
Michigan	n/a	709	1.17	74.84
Montana	n/a	21	0.03	78.25
New Hampshire	n/a	22	0.04	79.28
Oklahoma	n/a	173	0.29	88.76
South Carolina	n/a	138	0.23	92.52
Utah	n/a	281	0.47	95.89
	Total	60,365	100	

Table 1

Panel B: Yearly Distribution of the Sample

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

Year	Frequency	Percent	Cumulative
1981	839	1.39	1.39
1982	951	1.58	2.97
1983	1,099	1.82	4.79
1984	1,331	2.20	6.99
1985	1,422	2.36	9.35
1986	1,565	2.59	11.94
1987	1,721	2.85	14.79
1988	1,714	2.84	17.63
1989	1,690	2.80	20.43
1990	1,693	2.80	23.23
1991	1,682	2.79	26.02
1992	1,832	3.03	29.05
1993	2,028	3.36	32.41
1994	2,277	3.77	36.19
1995	2,435	4.03	40.22
1996	2,646	4.38	44.60
1997	2,949	4.89	49.49
1998	2,926	4.85	54.34
1999	2,762	4.58	58.91
2000	2,663	4.41	63.32
2001	2,473	4.10	67.42
2002	2,294	3.80	71.22
2003	2,177	3.61	74.83
2004	2,190	3.63	78.45
2005	2,217	3.67	82.13
2006	2,198	3.64	85.77
2007	2,199	3.64	89.41
2008	2,169	3.59	93.00
2009	2,145	3.55	96.56
2010	2,078	3.44	100.00
Total	60,365	100	

Table 1

Panel C: Descriptive Statistics

This table shows the descriptive statistics of the variables included in analyses. *Earnings Management* is measured based on Hutton et al. [2009]. *Analyst Coverage* is measured as a number of analysts following a firm. *Analyst Accuracy* is measured as an absolute value of the difference between mean analyst forecast and actual earnings per share scaled by actual earnings (Call et al. [2009]). *Bog Index* is the measure of 10-K readability (Bonsall et al. [2017]). *Abnormal CFO, Abnormal DEXP, Abnormal PROD* are real earnings measures (Roychowdhury, [2006]). *Modified Q* is calculated following Peters and Taylor [2017]. *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. *Dividend Payout Ratio* is dividend payments scaled by net income. *Statute* is a dummy variable with value 1 for a year when the firm incorporated in a state that adopted constituency statutes and after that; otherwise 0. *Control Share Law*, *Business Conditions Law*, *Fair Price Law*, and *Poison Pill Law* are other anti-takeover laws (Karpoff and Wittry [2018]). *ROA* is a return on assets measured as total earnings divided by total assets. *Size* is the log value of total assets. *Leverage* is measured as the ratio of total debt to total assets. *Institutional Investor Holdings* is the proportion of shares held by institutional investors. *KZ Index* is based on the Lamont et al. [2001] five-factor model.

Variable	Observations	Mean	Std. Dev.	Min	Max
Dependent Variables					
Earnings Management	50,432	0.071	0.125	0.001	2.316
Analyst Coverage	60,365	3.645	3.680	1	38
Analyst Accuracy	50,432	0.039	0.089	0	3.031
The Bog Index	36,729	82.591	7.982	48	139
Abnormal OCF	44,561	0.001	0.139	0.585	0.343
Abnormal Disc. Expenses	12,369	0.003	0.287	0.561	1.024
Abnormal Prod. Cost	43,000	0.000	0.249	0.754	0.756
Modified Tobin's Q	59,864	1.278	1.905	0.528	12.129
Coverage Ratio	50,116	25.272	142.040	-430.333	1,033.000
Dividend Yield	21,041	0.025	0.018	0.001	0.088
Dividend Payout	45,285	0.226	0.522	0.000	3.777
Independent Variables					
Statute	60,365	0.247	0.431	0	1
Control Share Law	60,365	0.222	0.416	0	1
Business Combination Law	60,365	0.784	0.412	0	1
Fair Price Law	60,365	0.232	0.422	0	1
Poison Pill Law	60,365	0.249	0.433	0	1
ROA	60,365	0.094	0.180	0.843	0.399
Size	60,365	5.766	1.827	2.000	10.447
Leverage	60,365	0.230	0.210	0.000	0.966
Institutional Investor Holdings	60,365	0.450	0.275	0.002	1.082
KZ Index	57,572	-1.976	11.96	-91.923	18.499

Table 2

Constituency Statutes and Earnings Management

This table shows the effect of constituency statutes on earnings management. *Earnings Management* is measured based on Hutton et al. [2009]. *Statute* 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 other anti-takeover laws (Karpoff and Wittry [2018]). *ROA* is a return on assets measured as total earnings divided by total assets. *Size* is the log of total assets. *Leverage* is the ratio of total debt to total assets. *Institutional Investor Holdings* is the proportion of shares held by institutional investors. All regressions include a constant. Standard errors are reported in parentheses. * indicates significance at 10% level; ** indicates significance at 5% level; *** indicates significance at 1% level.

	(1) Earnings Management	(2) Earnings Management	(3) Earnings Management	(4) Earnings Management
Statute	0.006***	0.006**	0.006*	0.006*
	(0.002)	(0.002)	(0.003)	(0.003)
Control Share Law		0.001	-0.002	-0.002
		(0.006)	(0.006)	(0.006)
Business Conditions Law		0.003	0.001	0.001
		(0.003)	(0.004)	(0.004)
Fair Price Law		-0.006**	0.003	0.003
		(0.003)	(0.004)	(0.004)
Poison Pill Law		-0.001	-0.002	-0.002
		(0.002)	(0.002)	(0.002)
ROA			-0.117***	-0.117***
			(0.012)	(0.012)
Size			-0.030***	-0.030***
			(0.002)	(0.002)
Leverage			0.034***	0.034***
			(0.005)	(0.005)
Institutional Investor Holdings				-0.002
				(0.002)
Constant	0.068***	0.067***	0.250***	0.250***
	(0.001)	(0.004)	(0.014)	(0.014)
Observations	50,432	50,432	50,432	50,432
R-squared	0.542	0.542	0.565	0.565
Firm Fixed Effects	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes
Incorp. State Fixed Effects	Yes	Yes	Yes	Yes
Clustering: Incorp. State	Yes	Yes	Yes	Yes

Table 3

Constituency Statutes and 10-K readability

This table shows the effect of constituency statutes on 10-K readability. *Readability* is measured by the Bog index (Bonsall et al. [2017]). A high value of the Box index means more difficult to decipher a 10-K report. *Statute* 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 other anti-takeover laws (Karpoff and Wittry [2018]). *ROA* is a return on assets measured as total earnings divided by total assets. *Size* is the log value of total assets. *Leverage* is the ratio of total debt to total assets. *Institutional Investor Holdings* is the proportion of shares held by institutional investors. All regressions include a constant. Standard errors are reported in parentheses. * indicates significance at 10% level; ** indicates significance at 5% level; *** indicates significance at 1% level.

	(1) Readability	(2) Readability	(3) Readability	(4) Readability
Statute	0.772**	0.794**	0.861**	0.879**
	(0.369)	(0.371)	(0.397)	(0.401)
Control Share Law		-5.625***	-6.601***	-6.732***
		(1.437)	(1.464)	(1.464)
Business Conditions Law		0.215	0.163	0.199
		(0.359)	(0.392)	(0.400)
Fair Price Law		0.081	0.679	0.526
		(0.931)	(0.911)	(0.960)
ROA			-2.691***	-2.683***
			(0.286)	(0.289)
Size			0.432***	0.555***
			(0.081)	(0.076)
Leverage			0.737	0.640
			(0.711)	(0.703)
Institutional Investor Holdings				-1.216***
				(0.157)
Constant	82.379***	83.496***	81.050***	80.999***
	(0.103)	(0.294)	(0.575)	(0.554)
Observations	34,439	34,439	34,439	34,437
R-squared	0.742	0.742	0.743	0.744
Firm Fixed Effects	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes
Incorp. State Fixed Effects	Yes	Yes	Yes	Yes
Clustering: Incorp. State	Yes	Yes	Yes	Yes

Table 4

Constituency Statutes and Analyst Coverage

This table shows the effect of constituency statutes on analyst coverage. *Analyst Coverage* is measured as the number of analysts following a firm. *Statute* 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 other anti-takeover laws (Karpoff and Wittry [2018]). *ROA* is a return on assets measured as total earnings divided by total assets. *Size* is the log value of total assets. *Leverage* is measured as the ratio of total debt to total assets. *Institutional Investor Holdings* is the proportion of shares held by institutional investors. All regressions include a constant. Standard errors are reported in parentheses. * indicates significance at 10% level; ** indicates significance at 5% level; *** indicates significance at 1% level.

	(1) Analyst Coverage	(2) Analyst Coverage	(3) Analyst Coverage	(4) Analyst Coverage
Statute	-0.553**	-0.136	-0.056	-0.058
	(0.219)	(0.157)	(0.164)	(0.167)
Control Share Law		-0.314*	-0.152	-0.160
		(0.178)	(0.176)	(0.177)
Business Conditions Law		-0.038	-0.041	-0.041
		(0.129)	(0.122)	(0.122)
Fair Price Law		-0.111	-0.201	-0.199
		(0.199)	(0.236)	(0.240)
Poison Pill Law		-0.495**	-0.372*	-0.372*
		(0.233)	(0.205)	(0.207)
ROA			-0.127	-0.145
			(0.146)	(0.148)
Size			2.004***	1.940***
			(0.091)	(0.088)
Leverage			-1.148***	-1.085***
			(0.107)	(0.105)
Institutional Investor Holdings				0.636***
				(0.135)
Constant	3.830***	3.989***	-7.866***	-7.815***
	(0.060)	(0.127)	(0.504)	(0.507)
Observations	60,365	60,365	60,365	60,365
R-squared	0.735	0.735	0.785	0.786
Firm Fixed Effects	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes
Incorp. State Fixed Effects	Yes	Yes	Yes	Yes
Clustering: Incorp. State	Yes	Yes	Yes	Yes

Table 5

Constituency Statutes and Analyst Accuracy

This table shows the effect of constituency statutes on analyst accuracy. *Analyst Accuracy* is measured as an absolute value of the difference between mean analyst forecast and actual earnings per share scaled by actual earnings (Call et al. [2009]). *Statute* 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 other anti-takeover laws (Karpoff and Wittry [2018]). *ROA* is a return on assets measured as total earnings divided by total assets. *Size* is the log value of total assets. *Leverage* is the ratio of total debt to total assets. *Institutional Investor Holdings* is the proportion of shares held by institutional investors. All regressions include a constant. Standard errors are reported in parentheses. * indicates significance at 10% level; ** indicates significance at 5% level; *** indicates significance at 1% level.

	(1) Analyst Accuracy	(2) Analyst Accuracy	(3) Analyst Accuracy	(4) Analyst Accuracy
Statute	-0.007***	-0.009***	-0.010***	-0.010***
	(0.002)	(0.002)	(0.003)	(0.003)
Control Share Law		0.002	0.002	0.002
		(0.003)	(0.004)	(0.004)
Business Conditions Law		-0.003	-0.002	-0.002
		(0.003)	(0.003)	(0.003)
Fair Price Law		-0.001	0.001	0.001
		(0.004)	(0.005)	(0.005)
Poison Pill Law		0.002	0.002	0.002
		(0.002)	(0.002)	(0.002)
ROA			0.059***	0.059***
			(0.005)	(0.005)
Size			-0.008***	-0.009***
			(0.001)	(0.001)
Leverage			-0.006*	-0.006*
			(0.003)	(0.003)
Institutional Investor Holdings				0.005
				(0.004)
Constant	-0.037***	-0.035***	0.014*	0.014*
	(0.001)	(0.003)	(0.008)	(0.007)
Observations	50,432	50,432	50,432	50,432
R-squared	0.720	0.720	0.724	0.724
Firm Fixed Effects	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes
Incorp. State Fixed Effects	Yes	Yes	Yes	Yes
Clustering: Incorp. State	Yes	Yes	Yes	Yes

Table 6

Constituency Statutes and Institutional Investor Ownership

This table shows the effect of constituency statutes on governance using institutional ownership as a proxy. The sample is divided based on firms' profitability with *Earnings Per Share* below zero (EPS<0) and *Earnings Per Share* above zero (EPS>0). *Governance* is the proportion of shares held by institutional investors. *Statute* 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 other anti-takeover laws (Karpoff and Wittry [2018]). *ROA* is a return on assets measured as total earnings divided by total assets. *Size* is the log value of total assets. *Leverage* is the ratio of total debt to total assets. All regressions include a constant. Standard errors are reported in parentheses. * indicates significance at 10% level; ** indicates significance at 5% level; *** indicates significance at 1% level.

	EPS<0		EPS>0	
	(1) Governance	(2) Governance	(3) Governance	(4) Governance
Statute	-0.054***	-0.040**	0.002	0.002
	(0.018)	(0.020)	(0.010)	(0.005)
Control Share Law		0.003		0.001
		(0.031)		(0.007)
Business Conditions Law		-0.036*		0.010**
		(0.020)		(0.005)
Fair Price Law		0.009		0.008
		(0.024)		(0.008)
Poison Pill Law		-0.007		0.004
		(0.016)		(0.005)
ROA		-0.092***		0.115***
		(0.011)		(0.015)
Size		0.113***		0.101***
		(0.004)		(0.002)
Leverage		-0.003		-0.137***
		(0.012)		(0.008)
Constant	0.393***	-0.144***	0.520***	-0.107***
	(0.004)	(0.026)	(0.003)	(0.014)
Observations	11,242	11,242	38,036	38,036
R-squared	0.795	0.827	0.798	0.821
Firm Fixed Effects	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes
Incorp. State Fixed Effects	Yes	Yes	Yes	Yes
Clustering: Incorp. State	Yes	Yes	Yes	Yes

Table 7

Cross-sectional Tests of Constituency Statutes and Earnings Management

This table shows the effects of constituency statutes on earnings management based on firm size, governance, financial constraint, and growth opportunities. *Earnings Management* is measured based on Hutton et al. [2009]. *Statute* is a dummy variable with value 1 for a year when the firm incorporated in a state that adopted constituency statutes and after that; otherwise 0. *Large firm* is a dummy variable with value 1 for firm size above the median; otherwise 0. *High Constraint firm* is a dummy variable with value 1 for KZ index (Lamont et al. [2001]) above the median; otherwise 0. *High Growth firm* is a dummy variable with value 1 for firms with above-median Tobin's Q (the ratio of market value to book value of equity). *Low Governance firm* is a dummy variable with value 1 for firms below the median holdings by institutional investors; otherwise 0. We include the same control variables as our baseline model, including *Control Share Law*, *Business Conditions Law*, *Fair Price Law*, *Poison Pill Law*, *ROA*, *Size*, *Leverage*, and *Institutional Investor Holdings.* All regressions include a constant. Standard errors are reported in parentheses. * indicates significance at 10% level; ** indicates significance at 5% level; *** indicates significance at 1% level.

	(1) Earnings Management	(2) Earnings Management	(3) Earnings Management	(4) Earnings Management
Statute	0.001	0.005**	0.006**	0.009***
	(0.003)	(0.002)	(0.003)	(0.002)
Large firm	-0.021***			
	(0.001)			
Statute × Large firm	0.008***			
	(0.002)			
High Constraint firm		0.005***		
		(0.001)		
Statute × High Constraint firm		0.001		
		(0.002)		
High Growth firm			-0.002	
			(0.001)	
Statute × High Growth firm			0.001	
			(0.002)	
Low Governance firm				0.013***
				(0.001)
Statute × Low Governance firm				-0.007***
				(0.002)
Constant	0.080***	0.066***	0.069***	0.062***
	(0.001)	(0.001)	(0.001)	(0.001)
Observations	50,432	48,094	50,430	50,432
R-squared	0.543	0.541	0.542	0.542
Firm Fixed Effects	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes
Incorp. State Fixed Effects	Yes	Yes	Yes	Yes
Clustering: Incorp. State	Yes	Yes	Yes	Yes

Table 8

Alternative Measures of Earnings Management

This table provides various robustness checks to confirm the previous results. *Abnormal CFO*, *Abnormal DEXP*, *Abnormal PROD* are real earnings measures (Roychowdhury, [2006]). *Statute* 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 other anti-takeover laws (Karpoff and Wittry [2018]). *ROA* is a return on assets measured as total earnings divided by total assets. *Size* is the log value of total assets. *Leverage* is the ratio of total debt to total assets. *Institutional Investor Holdings* is the proportion of shares held by institutional investors. All regressions include a constant. Standard errors are reported in parentheses. * indicates significance at 10% level; ** indicates significance at 5% level; *** indicates significance at 1% level.

	(1) Abnormal CFO	(2) Abnormal DEXP	(3) Abnormal PROD
Statute	0.009**	-0.001	0.006
	(0.004)	(0.011)	(0.005)
Control Share Law	-0.002	0.005	0.002
	(0.008)	(0.015)	(0.007)
Business Conditions Law	0.004	0.009	-0.006
	(0.004)	(0.015)	(0.008)
Fair Price Law	-0.020***	-0.002	-0.004
	(0.002)	(0.019)	(0.008)
Poison Pill Law	-0.007***	0.039**	-0.011**
	(0.002)	(0.015)	(0.005)
ROA	0.447***	-0.086***	-0.652***
	(0.013)	(0.021)	(0.020)
Size	-0.004***	-0.049***	0.034***
	(0.001)	(0.009)	(0.002)
Leverage	-0.071***	-0.038	-0.004
	(0.008)	(0.025)	(0.005)
Institutional Investor Holdings	0.008	0.009	-0.017***
	(0.005)	(0.013)	(0.004)
Constant	-0.005	0.284***	-0.119***
	(0.010)	(0.062)	(0.016)
Observations	43,466	11,960	42,072
R-squared	0.719	0.867	0.862
Firm Fixed Effects	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes
Incorp. State Fixed Effects	Yes	Yes	Yes
Clustering: Incorp. State	Yes	Yes	Yes

Table 9

Self-Selection in the State of Incorporation and Firm Transparency

This table shows the effects of constituency statutes on firm transparency measures after resolving the self-selection problem. Using Jay Ritter's data on firms' incorporation year, we drop firms that were incorporated in the states after the adoption of constituency statutes. *Earnings Management* is measured based Hutton et al. [2009]. *Analyst Coverage* is measured as the number of analysts following a firm. *Statute* 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. We include the same control variables as our baseline model, including *Control Share Law*, *Business Conditions Law*, *Fair Price Law*, *Poison Pill Law, ROA, Size, Leverage,* and *Institutional Investor Holdings.* All regressions include a constant. Standard errors are reported in parentheses. * indicates significance at 10% level; ** indicates significance at 5% level; *** indicates significance at 1% level.

	(1) Earnings Management	(3) Analyst Coverage
Statute	0.027	-4.370
	(0.036)	(3.584)
Constant	0.030	2.530*
	(0.034)	(1.332)
Observations	5,687	7,050
R-squared	0.095	0.213
Controls	Yes	Yes
Firm Fixed Effects	Yes	Yes
Year Fixed Effects	Yes	Yes
Incorp. State Fixed Effects	Yes	Yes
Clustering: Incorp. State	Yes	Yes

Table 10

Delaware Incorporation State

This table shows the effect of constituency statutes on earnings management and analyst accuracy excluding the firm-year observations if the incorporation state is Delaware. *Earnings Management* is measured based on Hutton et al. [2009]. *Analyst Accuracy* is measured as an absolute value of the difference between mean analyst forecast and actual earnings per share scaled by actual earnings (Call et al., [2009]). *Statute* 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. We include the same control variables as our baseline model, including *Control Share Law*, *Business Conditions Law*, *Fair Price Law*, *Poison Pill Law*, *ROA*, *Size*, *Leverage*, and *Institutional Investor Holdings.* Standard errors are reported in parentheses. * indicates significance at 10% level; ** indicates significance at 5% level; *** indicates significance at 1% level.

Panel A: Distribution of Delaware Incorporation

Delaware_Incorporation	Freq.	Percent	Cum.
0	17,786	38.66	38.66
1	28,215	61.34	100
Total	46,001	100	

Panel B: Corporate Transparency and Stakeholder Orientation

	(1) Earnings Management	(2) Analyst Accuracy	(3) Earnings Management	(4) Analyst Accuracy
Statute	0.007***	-0.008***	0.007**	-0.009***
	(0.002)	(0.003)	(0.003)	(0.003)
Control Share Law			0.003	0.003
			(0.006)	(0.004)
Business Conditions Law			0.004	-0.004
			(0.004)	(0.004)
Fair Price Law			0.003	0.001
			(0.003)	(0.005)
Poison Pill Law			-0.001	0.000
			(0.002)	(0.003)
ROA			-0.079***	0.072***
			(0.012)	(0.014)
Size			-0.024***	-0.005***
			(0.003)	(0.002)
Leverage			0.023*	-0.003
			(0.013)	(0.008)
Institutional Investor Holdings			0.000	-0.008
			(0.005)	(0.007)
Constant	0.057***	-0.030***	0.196***	-0.004
	(0.001)	(0.002)	(0.016)	(0.010)
Observations	17,786	17,786	17,786	17,786
R-squared	0.566	0.629	0.583	0.633
Firm Fixed Effects	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes
Incorp. State Fixed Effects	Yes	Yes	Yes	Yes
Clustering: Incorp. State	Yes	Yes	Yes	Yes

Table 11

Incorporation and Headquarter State

This table shows the effect of constituency statutes on earnings management and analyst accuracy excluding the firm-year observations if incorporation state and headquarter state are the same. *Incorp Headquarter State* is equal to 1 if state of incorporation and state of headquarters are the same; otherwise 0. *Earnings Management* is measured based on Hutton et al. [2009]. *Analyst Accuracy* is measured as an absolute value of the difference between mean analyst forecast and actual earnings per share scaled by actual earnings (Call et al. [2009]). *Statute* 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. We include the same control variables as our baseline model, including *Control Share Law*, *Business Conditions Law*, *Fair Price Law*, *Poison Pill Law*, *ROA*, *Size*, *Leverage*, and *Institutional Investor Holdings.* All regressions include a constant. Standard errors are reported in parentheses. * indicates significance at 10% level; ** indicates significance at 5% level; *** indicates significance at 1% level.

Panel A: Distribution of Observations as per Incorporation and Headquarter State

Incorp_Headquarter_State	Freq.	Percent	Cum.
0	32,077	69.73	69.73
1	13,924	30.27	100
Total	46,001	100	

Panel B: Corporate Transparency and Stakeholder Orientation

	(1)	(2)
	Earnings Management	Analyst Accuracy
Statute	0.001	-0.020**
	(0.004)	(0.009)
Control Share Law	-0.002	0.006
	(0.008)	(0.005)
Business Conditions Law	0.001	0.001
	(0.010)	(0.009)
Fair Price Law	0.002	0.001
	(0.009)	(0.014)
Poison Pill Law	-0.003	0.007
	(0.004)	(0.008)
Constant	0.277***	0.019*
	(0.009)	(0.011)
Observations	32,077	32,077
R-squared	0.572	0.775
Controls	Yes	Yes
Firm Fixed Effects	Yes	Yes
Year Fixed Effects	Yes	Yes
Incorp. State Fixed Effects	Yes	Yes
Headquarter State-Year Fixed Effects	Yes	Yes
Clustering: Incorp. State	Yes	Yes

Table 12

Dynamics of the Treatment Effect

This table shows the dynamic effects of constituency statutes on earnings management. *Earnings Management* is measured based on Hutton et al. [2009]. *Statute* 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. *Statute(-2), Statute(-1), Statute(+1), and Statute(+2)* captures the dynamics of the treatment two years before the adoption year to two years after the adoption year. *Control Share Law*, *Business Conditions Law*, *Fair Price Law*, and *Poison Pill Law* are other anti-takeover laws (Karpoff and Wittry [2018]). *Size* is the log of total assets. *ROA* is a return on assets measured as total earnings divided by total assets. *Leverage* is measured as the ratio of total debt to total assets. *Institutional Investor Holdings* is the proportion of shares held by institutional investors. All regressions include a constant. Standard errors are reported in parentheses. * indicates significance at 10% level; ** indicates significance at 5% level; *** indicates significance at 1% level.

	(1) Earnings Management	(2) Earnings Management
Statute (-2)	-0.004	-0.005
	(0.005)	(0.006)
Statute (-1)	-0.004	-0.005
	(0.003)	(0.003)
Statute	0.014***	0.013***
	(0.004)	(0.005)
Statute (+1)	0.001	0.000
	(0.006)	(0.007)
Statute (+2)	0.002	0.001
	(0.006)	(0.005)
Control Share Law		0.001
		(0.005)
Business Conditions Law		-0.001
		(0.004)
Fair Price Law		0.006
		(0.003)
Poison Pill Law		-0.001
		(0.002)
ROA		-0.117***
		(0.013)
Size		-0.032***
		(0.002)
Leverage		0.037***
		(0.005)
Institutional Investor Holdings		-0.001
		(0.002)
Constant	0.067***	0.260***
	(0.001)	(0.017)
Observations	44,705	44,705
R-squared	0.551	0.574
Firm Fixed Effects	Yes	Yes
Year Fixed Effects	Yes	Yes
Incorp State Fixed Effects	Yes	Yes
Clustering: Incorporation State	Yes	Yes

Table 13

Real Cost of Conscious Capitalism

This table shows the impact of constituency statutes on interest coverage ratio, dividend payout, and dividend yield. *Coverage Ratio* is earnings before interest and tax scaled by interest expense. *Dividend Payout* is dividend payments scaled by net income. *Dividend Yield* is the ratio of dividend per share to the stock price per share. *Statute* 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. We include the same control variables as our baseline model, including *Control Share Law*, *Business Conditions Law*, *Fair Price Law*, *Poison Pill Law, ROA, Size, Leverage,* and *Institutional Investor Holdings.* All regressions include a constant. Standard errors are reported in parentheses. * indicates significance at 10% level; ** indicates significance at 5% level; *** indicates significance at 1% level.

	(1)	(2)	(3)
	Coverage Ratio	Dividend Payout	Dividend Yield
Statute	-8.472*	-0.013	-0.001*
	(4.433)	(0.018)	(0.001)
Constant	33.865***	0.229***	0.025***
	(3.440)	(0.014)	(0.000)
Observations	49,105	44,432	20,837
R-squared	0.420	0.335	0.700
Controls	Yes	Yes	Yes
Firm Fixed Effects	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes
Incorp State Fixed Effects	Yes	Yes	Yes
Clustering: Incorporation State	Yes	Yes	Yes

Appendix

A1: Modified Tobin's Q and Constituency Statutes

This table shows the effects of constituency statutes on modified Tobin's Q (Modified Q). *Modified Q* is calculated following Peters and Taylor [2017]. *Statute* 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 other anti-takeover laws (Karpoff and Wittry [2018]). *ROA* is a return on assets measured as total earnings divided by total assets. *Size* is the log of total assets. *Leverage* is the ratio of total debt to total assets. *Institutional Investor Holdings* is the proportion of shares held by institutional investors. Standard errors are reported in parentheses. * indicates significance at 10% level; ** indicates significance at 5% level; *** indicates significance at 1% level.

	(1) Modified Q	(2) Modified Q	(3) Modified Q	(4) Modified Q
Statute	0.024	0.104**	0.071	0.069
	(0.057)	(0.051)	(0.046)	(0.047)
Control Share Law		-0.021	-0.005	-0.006
		(0.090)	(0.080)	(0.080)
Business Conditions Law		-0.015	-0.008	-0.008
		(0.048)	(0.038)	(0.038)
Fair Price Law		-0.075	-0.051	-0.050
		(0.067)	(0.059)	(0.060)
Poison Pill Law		-0.067	-0.061	-0.059
		(0.049)	(0.041)	(0.042)
ROA			3.547***	3.545***
			(0.174)	(0.173)
Size			-0.116***	-0.133***
			(0.018)	(0.017)
Leverage			-0.591***	-0.575***
			(0.062)	(0.061)
Institutional Investor Holdings				0.172***
				(0.049)
Constant	1.267***	1.298***	1.751***	1.768***
	(0.014)	(0.049)	(0.108)	(0.106)
Observations	58,451	58,451	58,451	58,451
R-squared	0.575	0.575	0.605	0.606
Firm Fixed Effects	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes
Incorp State Fixed Effects	Yes	Yes	Yes	Yes
Clustering: Incorporation State	Yes	Yes	Yes	Yes

A2: 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.

A3: Variable Descriptions

Variable Name	Definition	Data Source
Earnings Management	Based on Hutton et al. [2009]	Compustat
Analyst Coverage	Number of analysts following the firm	I/B/E/S
Analyst Accuracy	Absolute value of the difference between mean analyst forecast and actual earnings per share scaled by actual earnings (Call et al. [2009])	I/B/E/S
Bog Index	A measure of 10-K readability based on Bonsall et al. [2017]	Brian P. Miller Website
Abnormal OCF	Real earnings management measures based on Roychowdhury [2006]	Compustat
Abnormal Disc. Expenses	Real earnings management measures based on Roychowdhury [2006]	Compustat
Abnormal Prod. Cost	Real earnings management measures based on Roychowdhury [2006]	Compustat
Modified Tobin's Q	Based on Peters and Taylor [2017]	WRDS (Contributed Data)
Statute	Dummy variable with value 1 for all years after the state of incorporation adopted constituency statutes (CS), otherwise 0. We use Flammer and Kacperczyk [2015] to know the years of CS adoption in each state.	Flammer and Kacperczyk [2015]
Control Share Law, Business Conditions Law, Fair Price Law, and Poison Pill Law	Dummy variable with value 1 for all years after the state of incorporation adopted any of these anti-takeover statutes (ATS), otherwise 0. We follow Karpoff and Wittry [2018] to know the years of adoption in each state. See Appendix A2 for more details.	Karpoff and Wittry [2018]
Size	Log of total assets	Compustat
ROA	Return on assets, measured as net income divided by average total assets	Compustat
Leverage	Long term debt divided by total assets	Compustat
Institutional Investor Holdings	Percentage of institutional investor holdings in total shares available to the public	Form 13 F
KZ Index	Kaplan – Zingales (KZ) index measures financial constraint of the firm. High KZ index means high financial constraint. Index is based on the Lamont et al. [2001] five-factor model	Compustat
Dividend Payout	Ratio of dividend payments to net income	Compustat
Coverage Ratio	Ratio of earnings before interest and tax to interest expense	Compustat
Dividend Yield	Ratio of dividend per share to the stock price per share	Compustat