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What are the Costs of Weakening Shareholder Primacy? Evidence from a U.S. Quasi-Natural Experiment

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## ABSTRACT

We study the consequences of weakening shareholder primacy using Nevada Senate Bill 203 as a quasi-natural experiment. A difference-in-differences analysis shows that, instead of improving their governance in response to the Bill to reassure capital providers, affected firms experience a governance deterioration. As a result, the law's adoption causes a drop in the valuation of firms incorporated in Nevada. These firms decrease the performance sensitivity of CEO pay, make more but worse acquisitions, and reduce the efficiency of their capital expenditures and R&D. Reducing shareholder primacy does not improve how stakeholders are treated, as ESG performance worsens.

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## 1. Introduction

Mainstream corporate governance doctrine in the U.S. posits that the board of directors' and officers' primary responsibility is to the shareholders. This is the doctrine of shareholder primacy. Typically, shareholders want the directors and officers to maximize firm value and, consequently, the duty of directors and officers is to maximize shareholder wealth. If directors and officers stray from their duty, shareholders, capital markets, and the market for corporate control have various mechanisms they can use to constrain or remove directors and officers. Shareholders can also use legal remedies. An alternative corporate governance doctrine is that the primary responsibility of directors and management is to the corporation's stakeholders. This stakeholder theory offers limited guidance when decisions affect stakeholders differently (Jensen, 2001), so that stakeholder theory gives substantially greater discretion to directors and officers than the shareholder supremacy theory. As a result, stakeholder theory makes it easier for insiders to pursue their own interests.

In the U.S., the corporate law that applies to a corporation is determined by the state of incorporation of the corporation. Delaware is the state of incorporation for an extremely large fraction of public corporations. Delaware law is explicit about the duty that the board of directors owes to the shareholders. The second most popular state for incorporation of public firms is Nevada. Nevada law does not have the doctrine of shareholder primacy and it protects directors and officers against litigation by shareholders. Despite Nevada's corporate law, before 2017, the Courts in Nevada still followed the Courts in Delaware, so that for practical purposes the doctrine of shareholder primacy still impacted judicial decisions for Nevada corporations. In 2017, the Nevada legislature put a stop to this practice by passing Senate Bill No. 203 (the Bill). This Bill made it crystal clear that the doctrine of shareholder primacy does not apply in Nevada and that directors and officers are protected against shareholder litigation. The adoption of this law represents a quasi-natural experiment (the Nevada experiment) to study the implications of weakening shareholder supremacy for shareholders and firm policies.

There is much evidence that examines implications of differences in shareholder protection across countries (La Porta, Lopez-de-Silanes, Shleifer, and Vishny, 2000). The advantage of the Nevada

experiment is that it represents a change in the level of shareholder protection for only some firms in the U.S. Hence, differences in economic development or national institutions do not affect our experiment. We can therefore focus directly on the impact of changes in corporate law that weaken the rights of shareholders and give more leeway to insiders to pursue other goals than shareholder wealth maximization. The U.S. has the advantage of high financial development, so that market mechanisms that can discipline management and boards are as developed as in any country. While the Berle and Means (1932) tradition in governance emphasizes the role of the law in ensuring that investors receive a return on their investment, the agency tradition following Jensen and Meckling (1976) emphasizes the role of market mechanisms (Ma and Shleifer, 2025). If market mechanisms predominate, the Nevada experiment should have little or no impact on firm governance and shareholder wealth. However, if the law plays a crucial role in firm governance in the presence of strong market mechanisms, we expect the Nevada experiment to affect governance and shareholder wealth adversely.

Given the nature of the Nevada experiment, we can compare the evolution of public firms subject to the law to the evolution of firms not subject to the law. For that purpose, we use a difference-in-differences (DiD) design for our investigation. Specifically, we compare the evolution of firms incorporated in Nevada to the evolution of other firms for the two years following the adoption of the law to the two years preceding the adoption of the law. We limit our investigation to the two years following the adoption of the law to avoid the impact of the COVID-19 crisis. Importantly, our empirical design is such that we compare the same firm after the adoption of the law to before the adoption of the law. Consequently, our results cannot be explained by changes in the composition of firms in Nevada or outside of Nevada.

In reaction to the passage of such a law, market mechanisms might lead insiders to strengthen their firm's corporate governance and bond themselves to courses of action favorable to shareholders. This is because market mechanisms would decrease the value of the firm and increase its cost of capital if it becomes less likely to maximize shareholder wealth. By strengthening corporate governance and bonding themselves to a course of action favorable to shareholders, insiders would decrease the firm's cost of capital and maximize shareholder wealth. We do not find them behaving that way. For insiders to take measures to

offset the impact of the law, the loss they make by not taking such measures has to be larger than the increase in private benefits that can be extracted from the firm by insiders with their greater protection. This suggests that the law enabled insiders to capture valuable private benefits.

The passage of the law appears to have a striking adverse effect on governance indicators typically used in the literature. We find that the entrenchment index of Bebchuk, Cohen, and Ferrell (2009) worsens, board independence falls, the busyness of directors increases, and director attendance drops. While the law frees insiders to pursue policies that are stakeholder friendly, insiders do not use the law to pursue such policies. If insiders pursued actions favorable to stakeholders, we would expect the ESG performance of firms to increase. We find that instead ESG performance worsens.

The quality of a firm's accounting is generally considered as an indicator of good governance from the perspective of capital providers (Bushman and Smith, 2001). Existing evidence on Nevada incorporated corporations already shows that these corporations have more restatements (Barzuza and Smith, 2014). We find Nevada firms experience an increase in accounting issues after the passage of the law. In particular, the firms' auditors become more likely to have concerns. We also find that these firms are more likely to receive an SEC letter pointing to issues with their reporting to the SEC.

The law may also influence how firms design executive compensation. There are two reasons why it could lead to an increase in CEO pay. First, the worsening of governance could enable management to pay itself more as it becomes more entrenched. Second, as insiders become better protected against litigation, they may push CEOs to take actions that are detrimental to their reputation, which would require them to be paid more. Alternatively, if insiders wanted to signal their commitment to increase shareholder wealth, they would increase the pay sensitivity of the CEO. We investigate the impact of the law's adoption on the excess pay and performance sensitivity of compensation of CEOs of Nevada companies. We find that the excess pay of these CEOs increases and the performance sensitivity of their compensation falls.

Institutional shareholders are often viewed as having a monitoring role (Coffee, 1991). They are part of the market mechanisms that help make it more likely that directors and officers maximize firm value. When shareholder primacy is weakened, institutional investors, particularly non-blockholders, may find it

more difficult to influence corporate decisions without complementary governance mechanisms. As a result, we expect a decline in overall institutional ownership, driven primarily by non-blockholders, and a more modest reduction in blockholder ownership. We find strong empirical support in the data for these predictions.

Public firms in the U.S. are subject to the federal securities laws. These laws enable shareholders to sue publicly traded corporations by the class action mechanism (securities lawsuits). This mechanism can serve as a disciplining mechanism for the board and officers when they are tempted to take actions detrimental to shareholders. We would expect this mechanism to be used more if a firm's corporate governance weakens. However, the Nevada law explicitly weakens the ability for shareholders to use that mechanism. As a result, we find that the frequency of securities lawsuits drops after the adoption of the law.

Since it seems clear that firms did not try to offset the impact of the law on shareholder supremacy, we would expect the law to have an adverse impact on firm value. Examination of this hypothesis is complicated by the fact that the adoption of the law was never in question (e.g., votes were unanimous). Therefore, the legislative process offered no clearly unexpected event, making it difficult to identify a market reaction using a standard event-study framework. Despite this, we do find a significant negative abnormal return on the day that the law became effective. Further, we find that Nevada incorporated public firms perform poorly in the two years following the adoption of the law. Many papers in the corporate governance literature use Tobin's $q$ as a valuation measure. A classic paper shows that Delaware firms have higher valuations using Tobin's $q$ (Daines, 2001). If this higher valuation is due at least in part to the shareholder primacy doctrine and more generally better protection of investor rights, we would expect firms incorporated in Nevada to experience a drop in their valuation following the passage of the law compared to firms incorporated in other states. We find that this is the case. Firms also experience a higher cost of debt following the adoption of the law. Our evidence suggests that the market mechanism is at work in penalizing firms for the weakening of shareholder primacy and investor rights.

We investigate further whether the decrease in valuation is related to the changes in governance. We find that the changes in governance are associated with changes in Tobin's $q$. Specifically, we find that the

greater the increase in the E-index, which is a measure of entrenchment, the greater the fall in Tobin's $q$. Similarly, the lower the decrease in board independence, the lower the fall in Tobin's $q$. We find consistent results for board busyness and for board attendance.

We then investigate how firms' investment policies change. By weakening shareholder primacy, the law potentially enables management to entrench itself and pursue investment strategies that align with managerial preferences but might not have been adopted under shareholder supremacy. However, it is also possible that the law made it possible for management and the board to be less risk-averse as they are less exposed to lawsuits. We find that firms make more acquisitions after the law and decrease asset sales. The changes for both acquisitions and asset sales are substantial. In addition, firms are more likely to make diversifying acquisitions after the passage of the law and more likely to experience impairments or write-offs. We also show that firms increase their number of segments, so that they become more diversified. Furthermore, we find that firms reduce capital expenditures significantly after the change in the law. In contrast, R&D expenses increase significantly by a similar magnitude. This shift from tangible investment to intangible investment might be viewed as a positive sign for theories of short-termism (Asker, Farre-Mensa, and Ljungqvist, 2015). They might suggest that a decrease in shareholder primacy is good for innovation. However, it is hard to reconcile such a conclusion with the decrease in firm value.

With weaker governance, we would expect investment to become less efficient. We find that firms make poorer acquisitions after the adoption of the law in that the market reacts more adversely to acquisition announcements. A measure of efficiency for capital expenditures is the sensitivity of investment to Tobin's $q$. With the $q$-theory of investment, firms should invest more when $q$ increases. We examine the sensitivity of investment to $q$. We find that investment essentially becomes insensitive to $q$ after the law's adoption. Lastly, we also find a decrease in R&D efficiency.

Our paper shows that firms do not respond to the weakening of the law by strengthening their internal governance to offset the adverse impact of the law on shareholder primacy. Instead, we find that weakening shareholder primacy not only hurts shareholders but also hurts economic efficiency. It is not the case that enabling insiders to take into account other stakeholders than shareholders means that they will do so as we

find that the ESG ratings of Nevada corporations fall following the passage of the Bill. These results add to a long literature about the role of laws and market mechanisms for corporate governance by showing that even in a country where market mechanisms are strong, weakening shareholder primacy has significant adverse effects on the value of corporations, on how they are run, and on how they invest.

The paper proceeds as follows. Section 2 introduces institutional background and empirical design. Section 3 describes our data and sample. Section 4 investigates how the Nevada experiment affected the governance of Nevada firms. Section 5 shows that the Bill led to a decrease in the value of Nevada firms. Section 6 examines the effects of the Bill on investment policies. Section 7 concludes.

## 2. The Nevada experiment

We first briefly discuss the evolution of Nevada corporate law and how the Nevada Senate Bill 203 fits in that evolution. We then review the main provisions of the Bill. Lastly, we explain how the experiment we consider motivates our empirical approach.

### 2.1. Nevada corporate law and Senate Bill 203

Delaware is by far the preferred choice for incorporation for public firms. We show in Figure 1 the number of firms incorporated in the five most popular states for incorporation. While Delaware is first, Nevada is second. On average, 79% of public corporations are incorporated in Delaware (Alon-Beck, 2024) and about 80% of firms going public choose to be incorporated in Delaware (Bainbridge, 2024). However, Bainbridge (2024) finds that out of the 67 public companies incorporated in Delaware that left Delaware, 49 chose to be incorporated in Nevada. DExit became more of an issue after Delaware found against Musk in the Tornetta v. Musk litigation concerning Musk's pay package. Musk responded to the decision by saying "Never incorporate your company in the state of Delaware. I recommend incorporating in Nevada or Texas if you prefer shareholders to decide matters."[2] Musk moved the incorporation of Neuralink as well

[2] "Elong Musk shifts Neuralink's incorporation to Nevada," by George Hammond and Sujeet Indap, *Financial Times*, February 9, 2024.

as X to Nevada. The Tornetta v. Musk decision is just one decision in a series of decisions that suggest to some observers that Delaware has become more receptive to shareholder litigation (Bainbridge, 2024).

The main difference between Delaware and Nevada in corporate law dates from a law passed in Nevada in 1987. The Nevada law of 1987 has lax protection of shareholders in the event of adverse actions by directors and officers compared to Delaware law (Barzuza and Smith, 2014). While Delaware does not allow corporations to exculpate directors and officers for breach of the duty of loyalty, the Nevada law of 1987 does so for most breaches. An important step in the evolution of the weakening of the liability of officers and directors for breach of the duty of loyalty was a legal reform in 2001 that eliminated monetary penalties for breaches of the duty of loyalty for all incorporated firms rather than just making this option available to firms in their charter. Eldar (2018) investigates this change and his analysis shows that it had no significant effect on Tobin's $q$. He also argues that this change may have been advantageous to shareholders for smaller fragile firms. These protections of directors and officers have been strengthened through time so that directors and officers are subject to personal liability only if their breach of a duty involves "intentional misconduct, fraud or a knowing violation of the law" (Barzuza, 2024). When it comes to conflicted transactions, Barzuza (2024) states that "Self-interested, conflicted transactions in Nevada are not subject meaningful judicial scrutiny."

Nevada Senate Bill 203, enacted in 2017, represents a significant development in the evolution of Nevada's corporate law. Over the course of several decades, the Nevada legislature sought to enhance the state's attractiveness as a jurisdiction for incorporation. A central motivation for this legislative agenda has been to provide clarity, predictability, and flexibility in corporate governance, differentiating Nevada from Delaware. An important feature of Nevada is that it is a state where the statute defines bright lines for liability while Delaware relies more on judicial interpretation that changes over time. La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1998) emphasize the greater protection of shareholders in common law countries compared to civil law countries. From the perspective of corporate law, Nevada is more like a civil law country and Delaware is more like a common law country.

Despite these efforts of the legislature, Nevada's statutory framework was often undermined by judicial interpretations that imported corporate governance principles from Delaware case law. For example, in cases such as Hilton Hotels Corp. v. ITT Corp. (1997) and Shoen v. SAC Holding Corp. (2006), courts applied Delaware judicial precedents that diluted the unique governance principles enshrined in Nevada's statutes. This judicial drift created uncertainty for corporations incorporated in Nevada, undermining the state's legislative intent to establish a governance model that explicitly permitted directors and officers to prioritize broader stakeholder interests and resist shareholder pressures. In response, Nevada Senate Bill 203 was introduced and enacted to reaffirm the state's commitment to a distinct corporate governance regime. Effective October 1, 2017, the legislation strengthened the autonomy of corporate directors and officers to pursue other objectives than shareholder wealth maximization and reduced their vulnerability to shareholder litigation.

### 2.2. Key Provisions of Senate Bill 203

Senate Bill 203 reaffirms the existing principle in Nevada that Nevada corporations, as well as their directors and officers, are governed by Nevada law rather than the laws of Delaware or any other jurisdiction. In particular, the Bill clarifies and strengthens Nevada's distinct corporate governance framework by providing more concrete and specific guidance on the fiduciary duties of directors and officers, as well as their discretionary powers.

A central feature of the Bill is the explicit recognition that directors and officers are not required to prioritize shareholder interests as the dominant consideration in their decision-making. The Bill authorizes directors and officers to consider a wide range of factors beyond shareholder value, including the interests of employees, customers, suppliers, creditors, the broader community, and societal impacts. It also highlights that directors may weigh both short-term and long-term corporate interests, giving them broader flexibility to make decisions aimed at the sustainability and independence of the corporation. This aligns with Nevada's intent to offer a governance model distinct from Delaware, emphasizing managerial discretion and a broader stakeholder perspective.

The Bill further provides clearer instructions on the circumstances under which directors and officers may rely on information provided by internal and external advisors. It also reinforces the protections offered by the business judgment rule, presuming that directors and officers act in good faith, on an informed basis, and in the best interests of the corporation unless proven otherwise. By raising the evidence threshold for challenging decisions made by directors and officers, the Bill reduces their exposure to personal liability for corporate actions and restricts shareholders' power. This clarification ensures that directors and officers can operate with confidence and make decisions that prioritize the long-term health of the corporation without undue interference from shareholder pressures.

In sum, by codifying these provisions, the Senate Bill 203 provides clearer and more concrete guidelines for directors and officers on their fiduciary duties and decision-making powers. It reinforces Nevada's commitment to a governance framework that allows directors and officers much discretion to cater to stakeholders and much protection from shareholder litigation, distinguishing itself from Delaware's shareholder-centric model.

### 2.3. Empirical Design: Difference-in-Differences Analysis

Our empirical design exploits the adoption of Nevada Senate Bill 203 (SB203) in 2017 as a quasi-natural experiment that weakened shareholder primacy by altering the legal duties of corporate directors and officers. We employ a difference-in-differences (DiD) framework to estimate the causal effects of the law on firm value, corporate governance, and investments.

To isolate medium-term effects and avoid transitional dynamics, we restrict the DiD analysis to a symmetric event window spanning two years before and after the law's adoption, excluding the event year (i.e., 2015-2016 vs. 2018-2019). We define the treatment group as firms incorporated in Nevada before SB203. We exclude firms that change their incorporation from other states to Nevada or exit from Nevada to other states during the event window. We require firms to appear at least one year during the pre-adoption period and one year during the post-adoption period to conduct the DiD analysis. Firms incorporated in other states serve as the control group. Our specification uses firm fixed effects so that our estimate of the

treatment effect can be interpreted as the estimate of the treatment effect on a given firm from before the change to after the change. Our estimate is therefore not affected by time-invariant observable and unobservable characteristics of firms.

Our baseline specification is as follows:

$$\mathrm{Y}_{it} = \beta_1 \cdot \mathrm{Treat}_i \times \mathrm{Post}_t + X_{it} \cdot \Gamma + \mu_i + \nu_t + \varepsilon_{it} \quad (1)$$

where *i* is the firm index and *t* is the year index, $\mathrm{Y}_{it}$ is the outcome variable of interest, $\mathrm{Treat}_i$ is an indicator for a firm incorporated in Nevada, and $\mathrm{Post}_t$ is an indicator equal to one for post-adoption years, X is a vector for time-varying firm-level covariates, $\Gamma$ is a vector for the corresponding coefficients, $\mu_i$ is firm fixed effects absorbing time-invariant variations within firm, and $\nu_t$ is year fixed effects. The interaction term is for the differential change in outcomes for treated firms relative to controls and its coefficient $\beta_1$ captures the treatment effect of the DiD analysis. $\mathrm{Treat}_i$ and $\mathrm{Post}_t$ do not appear individually in the specification because they are absorbed by the firm fixed effects and year fixed effects, respectively.

## 3. Data and Sample

We access annual accounting data from Compustat and stock market data from CRSP. Institutional ownership data is drawn from Thomson Reuters 13F filings, while corporate governance characteristics are obtained from Capital IQ and RiskMetrics. Analyst coverage data is from I/B/E/S (Institutional Brokers' Estimate System). Bank loan data are from Dealscan. Data on mergers and acquisitions are from SDC Platinum. Executive compensation information is obtained from ExecuComp. To measure R&D efficiency, we use the *Research Quotient* (Knott, 2008) available at WRDS. We collect data on securities litigation, regulatory actions, and auditor concerns from Audit Analytics. Environmental, social, and governance (ESG) performance measures are drawn from S&P TruCost. Firms' states of incorporation are extracted from SEC 10K filings. Our sample combines firm-level data from multiple sources spanning 2015 to 2019. We restrict the sample to U.S. incorporated, non-financial, non-utility firms with available data over the sample period. We exclude firms with stock prices below $1 to mitigate the influence of microcap and distressed firms. In our main sample, we have 151 treated firms (incorporated in Nevada) and 3,041 control

firms (incorporated in other states). All variables are winsorized at the 1st and 99th percentiles. Variable definitions are described in the Appendix.

Table 1 shows the means of variables for Nevada and non-Nevada firms separately in the year before the adoption of SB203 (i.e., 2016). Nevada firms differ in important dimensions from other listed firms. They are younger and smaller on average. From these differences, it follows that they have lower levels of institutional ownership and a higher Tobin's *q*, consistent with the finding by Barzuza and Smith (2014) that Nevada firms do not have a lower *q* than Delaware firms. Nevada firms do not have higher leverage or more cash holdings than other firms. They acquire less but have higher capital expenditures. Their E-index and board independence are not distinguishable from other firms. They have more auditor concerns than other firms but fewer impairments. They have lower block ownership. Nevada firms are followed by fewer analysts. The ESG scores of Nevada firms are not different from the ESG score of other firms, including their corporate governance indices (G scores). Despite the corporate law differences between Nevada and Delaware, the differences between Nevada and non-Nevada firms appear mostly driven by the difference in size and age. There is no significant difference in governance measures before the adoption of SB203.

## 4. The Nevada experiment and corporate governance

This section reports our empirical findings concerning the changes in firm governance resulting from the weakening shareholder primacy following the adoption of SB203. We first focus on internal governance measures. We then investigate external governance and monitoring. We show that there is a decrease in the alignment of CEO compensation with shareholder interests. Finally, we report that the broader discretion of directors and officers to consider the interests of stakeholders other than shareholders does not appear to benefit other stakeholders.

### 4.1. Internal corporate Governance

One concern about weakening shareholder primacy is that neither the firm nor management has a clear objective. Though the goal of maximizing shareholder wealth is unambiguous, any goal involving the

welfare of stakeholders is ambiguous in that it does not state how management and the board would deal with situations where an action improves the welfare of one type of stakeholders but hurts another type of stakeholders. It follows from Jensen and Meckling (1976) and the subsequent agency literature that if the legal rights of shareholders are weakened, firms could choose to change their governance to make it harder to pursue courses of action detrimental to shareholders at the expense of a loss of flexibility (Doidge, Karolyi, and Stulz, 2007). However, this presumes that firm-level governance can offset the adverse effects of weak legal protections, which may not be feasible if the private benefits made possible by weaker laws are too valuable for insiders to resist (Shleifer and Vishny, 1997; La Porta, Lopez-de-Silanes, Shleifer, and Vishny, 2000). We examine whether firm-level corporate governance improves or worsens as a result of SB203.

To empirically examine the effects of SB203 on corporate governance, we consider first four widely used internal governance measures: E-index (Bebchuk, Cohen, and Farrell, 2009),[3] %Busy (the fraction of directors serving on more than two outside boards), Bad Attendance (an indicator equal to one if any director misses more than 25% of board meetings in a given year), and Board Independence (measured as the number of independent directors scaled by the number of directors). Each of these governance measures is used as the dependent variable in Equation (1), and the estimates are reported in Table 2.

Column 1 reports the result for the E-index. A higher value of the E-index indicates more managerial entrenchment. The coefficient on Treat × Post is positive and statistically significant at the 1% level, indicating management becomes more entrenched following the adoption of SB203. The coefficient of 0.111 indicates a relative increase in the E-index of 10% of its standard deviation (1.063). Columns 2 and 3 show the impact on the busyness and board attendance, respectively. The coefficients on Treat × Post are positive and statistically significant at the 1% level in both columns, indicating that board members tend to

[3] The E-index, developed by Bebchuk, Cohen, and Ferrell (2009), is a governance measure that captures the degree of managerial entrenchment based on the presence of six antitakeover provisions. These provisions are: 1) staggered boards, 2) limits to shareholder amendments of bylaws, 3) limits to shareholder amendments of the charter, 4) supermajority requirements for mergers, 5) poison pills, and 6) golden parachutes. The index ranges from 0 to 6, with higher values indicating greater entrenchment and weaker shareholder rights.

be less focused on and less involved in the firm's business. The coefficient of 0.006 (0.055) in Column 2 (3) indicates a relative increase of 5% (28%) of its standard deviation [0.11 (0.199)]. Column 4 shows the estimate for board independence. The coefficient on the interaction term Treat × Post is negative and statistically significant at the 1% level, indicating that the law leads to a decline in the proportion of independent directors. The coefficient of -0.006 indicates a relative decrease as 6% of its standard deviation (0.103). All these findings provide consistent evidence for a broad weakening of board oversight following the erosion of shareholder primacy.

4.2. External governance and monitoring

In this section, we investigate how external governance and monitoring evolve following the adoption of the Bill. As SB203 reinforces the presumption that directors and officers act in good faith and explicitly limits their personal liability to cases where they willingly and knowingly break the law, its adoption is expected to reduce the litigation risk faced by them. In particular, the likelihood of securities lawsuits, one potential form of external monitoring, is expected to decline, thereby weakening a mechanism through which shareholders could hold corporate insiders accountable. To test this hypothesis, we define a dummy variable, Securities Lawsuits, which equals one if a firm has a securities lawsuit in a year and zero otherwise. We use this dummy variable as the dependent variable in Equation (1) and Column 1 of Table 3 reports the result. The coefficient on Treat × Post is negative and statistically significant at the 1% level. Specifically, the coefficient of -0.023 means the likelihood of securities lawsuits is reduced by 2.3%, which is 42% of the sample mean (0.055), consistent with the legal shift reducing the liability risk faced by directors and officers.

High quality accounting makes it easier for shareholders to monitor the company. Hence, the greater the accounting concerns of auditors, the lower the ability of shareholders to monitor the performance of the company effectively. We would expect accounting issues to arise more frequently as the board becomes less concerned about the adverse impact of such issues. Auditor concern refers to formal expressions of doubt or risk issued by a firm's external auditor regarding the firm's financial reporting or going concern

status. Auditors act as a key external monitor of management behavior and financial integrity. We would expect a deterioration of internal governance to adversely affect the quality of accounting. We thus expect greater concerns from auditors following SB203. We define a dummy variable, Auditor Concern, which equals one if a firm's auditor raises a concern about the firm in a year and zero otherwise. We use this dummy variable as the dependent variable in Equation (1) and Column 2 reports the result. The coefficient on Treat × Post is positive and statistically significant at the 1% level. Specifically, the coefficient of 0.013 means the likelihood of auditor flagging a concern increased by 1.3%, which is 37% of the sample mean (0.035), consistent with the notion that weakening shareholder power can lead to greater concerns of auditors as important external monitors.

An SEC comment letter is a formal communication from the U.S. Securities and Exchange Commission (SEC) to a publicly traded company, typically issued after the SEC staff reviews the company's filings, such as 10-Ks or 10-Qs.[4] These letters raise questions, request clarifications, or flag potential deficiencies in the company's disclosures or accounting practices. Following SB203, the weakened governance and oversight can lead to deterioration in the quality or transparency of financial reporting, and regulators may increase scrutiny. We thus expect greater regulatory scrutiny following SB203. We define an indicator variable, SEC Letter, which equals one if a firm receives an SEC letter within a year and zero otherwise. We use this dummy variable as the dependent variable in Equation (1) and Column 3 reports the result. The coefficient on Treat × Post is positive and statistically significant at the 1% level. Specifically, the coefficient of 0.126 means the likelihood of receiving an SEC letter increased by 12.6%, which is 34% of the sample mean (0.376), consistent with our evidence of a weakening in governance: one would expect such a weakening to result in more situations that raise concerns from the SEC.

As discussed in the introduction, it is generally accepted that institutional investors perform a monitoring role. However, monitoring by institutional investors involves costs and efforts. If monitoring by institutional investors has less impact because directors and officers have fewer reasons to be responsive,

[4] More details on the filing review process are available at https://www.sec.gov/divisions/corpfin/cffilingreview.htm.

then we would expect institutional ownership to fall. We next examine how the weakening of shareholder primacy under SB203 affects firms' ownership structure and information production. Weakening shareholder rights can lead to a retreat by institutional investors, particularly non-blockholders, who are likely to lack the influence or incentives to monitor effectively in the face of diminished legal protections. In contrast, it is usually more costly for blockholders to retreat due to the potential large price impact when they sell their holdings. As a result, we expect a decline in total institutional ownership, driven primarily by non-blockholders, and a weaker decrease in blockholder ownership. These shifts in ownership composition are also likely to affect the level of information production, measured by analyst coverage, which is expected to decline as the institutional investor base becomes smaller.

Column 4 shows that total institutional ownership declines significantly following the adoption of SB203. The coefficient on Treat × Post is negative and statistically significant at the 1% level. The coefficient of -0.024 indicates a 3% (10%) decline relative to its sample mean of 0.758 (standard deviation of 0.240). Column 5 reveals that this decrease is driven by a significant reduction in non-blockholder ownership, with a coefficient of -0.022 ($p < 0.01$), or a 5% (12%) drop relative to its sample mean of 0.459 (standard deviation of 0.189). In contrast, Column 6 shows that blockholder ownership only decreases slightly, with a coefficient of -0.004 ($p < 0.10$), representing a 1% (3%) decrease relative to its sample mean of 0.299 (standard deviation of 0.146). These patterns suggest that both non-block institutional investors and blockholders withdraw in response to the legal weakening of shareholder primacy, between them the former (typically less empowered) retreats more aggressively than the latter (more costly for them to sell their holdings). In general, a decrease in block ownership is viewed negatively from the perspective of governance (Shleifer and Vishny, 1986). Finally, Column 7 shows a decline in analyst coverage, with a coefficient on Treat × Post of -0.418 ($p < 0.01$), or a decline of 5% (6%) of the average coverage of 8.925 (standard deviation of 7.586), indicating a reduction in firm-level information production and external scrutiny. Collectively, these results show evidence that weakening shareholder primacy reshapes the firm's ownership structure. We find a decrease in institutional ownership, mainly driven by the decrease in non-blockholder ownership. Analyst coverage also declines significantly.

### 4.3. CEO Compensation: Excess pay and Incentives

CEO compensation is an important instrument to align managerial incentives with shareholder interests. Under the doctrine of shareholder primacy, optimal contracts are designed to tie pay closely to firm performance, thereby mitigating agency conflicts (Jensen and Murphy, 1990). If shareholder rights weaken, managerial incentives may become less aligned with shareholder interests. For instance, directors may want management to pursue policies that are inconsistent with shareholder wealth maximization, but may be advantageous for some directors. In such a situation, we would expect managerial pay to increase to compensate management for potential reputation loss from taking actions that hurt shareholder wealth, but we would also expect managerial compensation to be less well aligned with shareholder interests. Therefore, lower pay-performance sensitivity would be expected.[5] Alternatively, an increased ability of managers to extract rents as a result of weakened shareholder primacy would also lead to an increase in managerial compensation and to lower pay-performance sensitivity. We test these predictions by examining two compensation outcomes: Excess Pay, defined as the residual from a compensation regression controlling for firm and CEO characteristics, and Delta, a pay-performance sensitivity measure capturing the dollar change in CEO wealth for a 1% change in the firm's stock price. Both measures are widely used in the literature and allow us to assess whether the erosion of shareholder primacy leads to a shift in the level and structure of CEO incentives. Table 4 reports the results.

In Column 1, the dependent variable is excess pay, defined as the residual from a regression of log(Total Pay) on log(Assets), debt/assets, cash/assets, Tobin's *q*, and stock return. The coefficient on Treat × Post is positive and statistically significant at the 5% level, which indicates that excess pay increases significantly for treated firms following the adoption of SB203 as expected. Column 2 reports the effect on the sensitivity of compensation to stock performance (natural logarithm of Delta). The coefficient on Treat × Post is negative and statistically significant at the 1% level, suggesting a decline in incentive alignment (i.e., Delta

[5] Consistently, from an agency perspective, CEOs facing reduced monitoring may prefer lower pay-performance sensitivity to facilitate shirking.

decreases by 29.7%). While this reduction in pay-performance sensitivity may be consistent with a shift away from shareholder-centered contracting in the post-SB203 environment, it is unlikely to improve firm value. Rather, it points to weaker managerial incentives to maximize shareholder wealth, reinforcing the broader evidence of deteriorating governance quality.

### 4.4. Did SB203 lead to better treatment of stakeholders?

The Bill explicitly allows directors and officers to focus on the interests of other stakeholders besides shareholders. We investigate whether stakeholders other than shareholders benefitted from the Bill. A straightforward measure of whether the Bill improved the situation of stakeholders other than shareholders is to examine whether it affects firms' ESG performance. A frequently discussed justification for weakening shareholder primacy is to allow managers and directors to consider the interests of all stakeholders, e.g., employees, customers, communities, and the environment, rather than maximizing shareholder value alone. In principle, such a shift could enhance corporate responsibility and generate positive externalities for society. However, delivering meaningful improvements in ESG performance often requires sustained managerial effort and the allocation of firm resources. When shareholder rights and monitoring of management are weakened, it does not follow that insiders necessarily want to improve the situation of stakeholders as opposed to pursue other objectives, such as increasing the private benefits they can extract from the corporation. As such, the effect of SB203 may not help stakeholders even though insiders are given latitude to do so. We use an index of ESG performance to investigate whether stakeholders in general are helped by the Bill.

Table 5 presents the impact of SB203 on firms' ESG performance and the ESG-related data are from the S&P Trucost dataset. Column 1 shows that the overall ESG score declines significantly following the law's adoption. The coefficient on Treat × Post is -5.276, statistically significant at the 1% level. Given a sample mean of 35.201, this corresponds to a 15.0% reduction in ESG performance, a sizable decline. Columns 2 through 4 decompose the ESG score into its three subcomponents. The Environmental (E) score drops by 2.229 (Column 2), a 6.8% decline relative to its mean of 32.705. The Social (S) score falls by

4.737 (Column 3), or 16.6% of the mean value of 28.559. Finally, the Governance (G) score decreases by 6.435 (Column 4), a 15.4% decline relative to the mean of 41.808. All effects are statistically significant at the 1% level.

These results suggest that despite the legal shift toward allowing greater stakeholder consideration under SB203, firms' actual ESG performance deteriorates across all dimensions, environmental, social, and governance. These findings provide no support for the view that relaxing shareholder primacy improves stakeholder welfare. Instead, they suggest that the broadening of managerial discretion under SB203 did not help stakeholders other than shareholders. A plausible explanation for this outcome is that insiders may be pushed by institutional investors to pay attention to their firm's ESG performance, so that when shareholder primacy weakens, these investors have less influence on the actions of the insiders.

## 5. Firm Value and the Adoption of Nevada Senate Bill 203

In this section, we first examine the impact of the Bill on shareholder wealth and Tobin's $q$. We then further investigate whether the impact on Tobin's $q$ is correlated with the adverse effect of the Bill on governance documented in Table 2. Finally, we show the impact of the Bill on the cost of debt.

### 5.1. Impact of the Bill on the stock price

To examine the stock-price reaction to the passage of a law, it is best when there is controversy about whether the law will be passed or not. With SB203, there was no controversy. The law passed the Nevada Senate unanimously on May 19, 2017. It then passed the Nevada Assembly unanimously on June 5. The law was delivered to the governor on June 8 and he approved it on June 12. The law became effective on October 1, 2017. The only significant short-term reaction to the law is when it became effective. We study the short-run market reaction in a two-day window (i.e., [0, +1]). As the adoption of SB203 could potentially affect all stocks of firms incorporated in Nevada, cross-sectional correlations among stock returns could lead to high false positive results (Cohn, Johnson, Liu, and Wardlaw, 2024; Fahlenbrach, Ko, and Stulz, 2025). We thus follow Cohn et al. (2024) and use generalized least squares with time-series standard errors

of estimates to address the concern of cross-sectional correlations. Specifically, we use daily returns over 252 trading days prior to the effective date (i.e., October 1, 2017) to calculate the covariance matrix and the time series of estimates. Panel A of Table 6 reports abnormal returns over the [0, +1] window surrounding the law's effective date, using the market model, Fama-French three-factor model, and Fama-French plus momentum model, respectively. The abnormal returns are negative and range from -1.21% to -1.55%, statistically significant at the 1% level. These results indicate that investors interpreted the law's passage as detrimental to shareholder wealth, consistent with the idea that weakening shareholder primacy undermines firm performance and increases concerns about conflicts of interest.

Turning to the long-term stock return performance following the adoption of the law, Panel B examines abnormal returns over the two years following the law's adoption. Using the Barber and Lyon (1997) matched portfolio approach, we find economically meaningful and statistically significant negative abnormal performance. Treated firms underperform matched peers by approximately 14.4% on both an equal-weighted and value-weighted basis ($p$-value 0.06). Taken together, the short- and long-run abnormal return results provide consistent evidence that markets reacted negatively to the weakening of shareholder primacy.

### 5.2. The Nevada experiment and Tobin's $q$

In this section, we estimate DiD regressions using Tobin's $q$ (or its natural logarithm) as the dependent variable. The empirical specification follows Equation (1), and the analysis compares firm value over an event window of two years before and two years after the law's adoption in 2017. A key identifying assumption in our DiD design is that treated and control firms would have followed parallel trends in firm value in the absence of the law change. To check the validity of this assumption, Figure 2 plots dynamic treatment effects by estimating event-time coefficients from a regression of Tobin's $q$ on relative year indicators, using the year before the event as the benchmark. The regression includes the same set of controls, firm fixed effects, and year fixed effects as in our baseline specification (Column 3 of Table 7). The error bars represent 90% confidence intervals based on standard errors clustered at the state of

incorporation level. Figure 2 shows that, allowing for control variables and fixed effects, Tobin's *q* for Nevada firms is statistically indistinguishable from that of control firms in the two years prior to the law's adoption, supporting the validity of the parallel trends assumption. Following the law's implementation, however, treated firms experience a sharp and statistically significant decline in Tobin's *q* in both t+1 and t+2, consistent with a negative treatment effect on firm value.

Our main findings on the treatment effect of Nevada Senate Bill 203 on firm value are reported in Table 7. The odd-numbered columns use Tobin's *q* as the dependent variable, while the even-numbered columns use its natural logarithm. Columns 1 and 2 present specifications without additional controls; Columns 3 and 4 add controls for firm size, leverage, and cash holdings. All regressions include firm and year fixed effects, and standard errors are clustered at the incorporation state level. The treatment effect, captured by the interaction term Treat × Post, is consistently negative and statistically significant at the 1% level across all specifications. For example, Column 3 shows a decline in Tobin's *q* of 0.340 following the law's adoption. The log specification in Column 4 yields a coefficient of -0.058, implying a 5.8% relative decline in Tobin's *q* for treated firms compared to control firms. These findings provide strong evidence that weakening shareholder primacy leads to a significant reduction in firm value.

To assess the robustness of our baseline findings, we conduct various robustness tests, which are reported in the Internet Appendix. Table IA1 re-estimates the treatment effect of SB203 on Tobin's *q* using alternative fixed effects structures. Panel A includes industry-year fixed effects to account for potential confounding from time-varying industry shocks. The treatment effect remains negative and statistically significant across all specifications, and the economic impacts are similar to those in our main analysis. Panel B introduces more granular interacted year-fixed effects, where we control for quartile-based variation in firm size, leverage, and cash holdings by interacting each with year indicators. These specifications account for potential heterogeneous time trends based on key firm characteristics. The results remain consistent, with Tobin's *q* declining by 0.243 to 0.287 and the log specification indicating a 5.2% to 6.4% drop, all significant at the 1% level. These findings reinforce the finding that the observed decline in firm value is robust to alternative forms of unobserved heterogeneity. Panel C presents the results using

Total *q* as an alternative measure of firm value (Peters and Tayor, 2017), with various fixed effect settings. The results remain consistent and the coefficients on Treat x Post are all negative and statistically significant at the 1% level.

Robustness tests using a propensity score matched (PSM) approach are reported in Internet Appendix Table IA2, which address potential concerns about systematic differences between treated and control firms. Specifically, each treated firm is matched to up to five control firms based on industry and firm size (total assets) in the year prior to the law's adoption. The estimated treatment effect remains negative and statistically significant at the 1% level. Specifically, Tobin's *q* declines by 0.431 to 0.454, while the log specification indicates a 6.9% to 7.7% drop. These robustness tests demonstrate that our baseline results are unlikely to be driven by observable differences between Nevada firms and the broader sample.

One concern in DiD analyses of law adoption is that new legislation may be correlated with local economic conditions, which are typically tied to firm headquarter locations. This raises the possibility that observed effects could reflect local economic shocks rather than the legal change itself. As robustness tests, we thus exclude firms that are incorporated in their headquarter state. The results, reported in Panel A of Internet Appendix Table IA3, remain robust.[6]

When shareholder primacy is weakened, debtholders can also be affected and so do firms' borrowing costs. On the one hand, debtholders may view that, by reducing the liability exposure of directors and officers and expanding managerial discretion, the law weakens internal and external governance mechanisms that may protect creditors by limiting extraction of private benefits by insiders and may offer creditors more trustworthy information about the creditworthiness of the firm. Therefore, such concerns may lead to a higher cost of debt. On the other hand, by explicitly allowing managers to consider the

[6] Another concern in DiD analyses of law adoption is that firms may influence legislation to pursue their interests by lobbying (Karpoff and Wittry, 2018). Ideally, one would address this concern by excluding firms that actively lobbied for SB203. However, as far as we know, detailed firm-level lobbying records for Nevada are not publicly available for the relevant period. Available state-level lobbying data from the Nevada Legislature (www.leg.state.nv.us) begins in 2021, well after the law's passage. Nevertheless, we exclude firms that are identified as registered lobbyists in Nevada in 2021 and re-estimate our baseline specifications. As shown in Panel B of Internet Appendix Table IA3, our results remain robust.

interests of multiple stakeholders, including debtholders, SB203 could be viewed as strengthening the position of creditors relative to shareholders. In this case, lenders may face lower expropriation risk and could respond by offering capital at more favorable terms (i.e., lower cost of debt). Therefore, the effect of weakening shareholder primacy on the cost of debt is theoretically ambiguous and thus an empirical question. We test these competing hypotheses by examining whether the law's adoption affects the borrowing costs of treated firms in the commercial loan market.

We measure firms' cost of borrowing using commercial loan data from Dealscan. Specifically, we consider the all-in spread drawn as the measure of borrowing cost, which is defined as the amount the borrower pays in basis points over Libor for each dollar drawn down. We use its natural logarithm as the dependent variable in Equation (1). The sample includes new loan facilities issued to treated and control firms in two years before and after the law's adoption, and Table 8 presents the relevant results. Across all specifications, the interaction term Treat × Post is positive and statistically significant, indicating that treated firms face higher loan spreads following the law's adoption. For example, Column 3 shows that the cost of borrowing increases by 6.6%. This result is economically meaningful and consistent with lenders believing that the law makes firms less creditworthy.

We further provide direct evidence that the degree of governance deterioration following the adoption of SB203 is associated with the reduction in firm value. We measure the reduction in governance quality by changes in the relevant governance measures around the adoption of the law. Specifically, for E-index (%Busy), we define a dummy variable IncEIndex (IncBusy) that equals one if the increase in the E-Index (%Busy) is above the median and zero otherwise, where the increase is the post-adoption average minus the pre-adoption average, and then scaled by the pre-adoption average. A larger increase indicates a greater reduction in governance quality. Therefore, IncEIndex (IncBusy) is an indicator of more severe deterioration in governance. For bad attendance, we define a dummy variable IncBadAttend that equals one if bad attendance does not exist before the adoption but appears after adoption, and zero otherwise. For board independence, we define a dummy variable IncBdInd that is equal to one if the increase in board independence is above the median and zero otherwise, where the increase is the post-adoption average

minus the pre-adoption average, and then scaled by the pre-adoption average. Therefore, IncBdInd is an indicator of smaller worsening of governance.

We use a triple-interaction setting in our analysis, interacting Treat, Post, and the dummy variables defined above. Firm fixed effects are included to control for within-firm time-invariant omitted variables. To control for potential time-varying effects among groups experiencing different changes in governance quality, we further include year-times-gov fixed effects, where gov stands for the corresponding governance variable defined above. Table 9 reports the results for the tests investigating whether the negative effect on firm value is stronger among firms that experienced larger deterioration in governance.

Column 1 through 3 report the results related to changes in the E-Index, %Busy, and Bad Attendance. The coefficient on the triple interaction term is negative and statistically significant at the 1% level, which indicates that the negative impact on firm value concentrates in firms with larger deterioration in governance. Column 4 presents the result related to board independence, showing that the coefficient on Treat × Post × IncBdInd is positive and statistically significant at the 1% level. It means that firms with a smaller decrease in board independence have less reduction in value. All these results suggest that the adverse valuation effects of SB203 are magnified in firms where governance became less effective, supporting the interpretation that the law leads to lower firm value through weakened ability of shareholders to protect their interests through effective governance.

**6. Investment policy**

We would expect the weakening of governance following the adoption of the Bill to impact investment policy. Accordingly, we examine two distinct channels of corporate investment: external investment, via acquisitions, and internal investment, via capital expenditures and R&D. The literature focuses more on agency issues for acquisitions and R&D than for capital expenditures (e.g., Jensen, 1993). We would therefore expect that if directors and officers have more discretion to pursue goals other than shareholder wealth maximization, they are likely to acquire more and invest more in R&D.

6.1. Level changes in investment policies

We begin with external growth, where weakened shareholder primary may enable management or insiders more broadly to pursue acquisitions, enabling them to pursue empire-building goals or risk-reducing goals involving diversification. However, increased acquisition activity could also reflect efficient reallocation of capital toward more productive assets if managers are responding to strategic opportunities. To disentangle these interpretations, we also investigate divestitures, which may signal an effort to shed underperforming units consistent with efficient capital reallocation. Furthermore, prior research shows that acquisitions, particularly those undertaken in firms with weaker governance, frequently lead to subsequent asset write-offs or goodwill impairments when anticipated synergies fail to materialize (Henning, Lewis, and Shaw, 2000; Gu and Lev, 2011). It is also possible that reduced litigation risk (shareholder lawsuits) could lead firms to lower their standards for asset valuation or internal controls. Therefore, management may recognize the impairments they had previously postponed because they now face less accountability. We thus expect impairments and asset write-offs to increase following the adoption of SB203. We then turn to internal growth strategies. If the firm increases acquisitions, it may come at the expense of capital expenditures. However, weakened shareholder primacy may encourage R&D spending, which is typically harder for outsiders to evaluate. These theoretical predictions motivate an empirical examination of how firms adjust both internal and external growth strategies following the adoption of SB203.

Table 10 reports the results on the effects of SB203 on firms' investment behavior. Column 1 shows acquisitions significantly increase following the adoption of SB203. The coefficient on Treat × Post is 0.004, statistically significant at the 1% level and representing a 16% increase relative to the sample mean of 0.025. Column 2 shows that the coefficient on Treat × Post is positive and statistically significant at the 1% level, indicating greater likelihood of diversifying acquisitions. In particular, the coefficient 0.050 indicates an increase of 27.9% of the sample mean of 0.179. Column 3 reports the result of impairments. Specifically, we define a dummy variable, Impairment, which equals one if a firm has an impairment or write-off in a year and zero otherwise. We use it as the dependent variable in Equation (1). The results show that the coefficient on Treat × Post is positive and statistically significant at the 1% level. Specifically, the

coefficient 0.077 means the likelihood of impairment increased by 7.7%, which is 44.8% of the sample mean (0.172). The rise in impairments observed in our sample likely reflects the deterioration in investment quality and post-acquisition performance resulting from the erosion of shareholder primacy. Column 4 reports the effect on the number of business segments, showing that the coefficient on Treat × Post is also positive and statistically significant at the 1% level, consistent with broader organizational expansion through diversifying acquisitions.

To assess whether these expansionary moves are accompanied by asset reallocation, Column 5 examines divestitures, measured by the ratio of asset sales to assets. The coefficient on Treat × Post is -0.002 and statistically significant at the 1% level, suggesting that treated firms are in fact less likely to divest assets, with a decline equal to approximately 100% of the sample mean of 0.002. This finding is inconsistent with the view that the law facilitated efficient asset reallocations. Columns 6 and 7 turn to internal growth. Column 6 shows that the coefficient on Treat × Post is negative and statistically significant at the 1% level, which indicates a 5% decline in capital expenditures relative to its sample mean of 0.041. Finally, Column 7 shows a significant increase in R&D expenses. The coefficient on Treat × Post is approximately equal in magnitude but opposite in sign to that for capital expenditures in Column 6, suggesting a substitution effect following the adoption of SB203: shifting internal growth from tangible investment toward more discretionary R&D spending.

Taken together, these findings indicate that following the weakening of shareholder primacy, firms shift toward external growth, particularly through diversifying acquisitions, while showing no evidence of asset reallocation through divestitures. Internal capital allocation shifts toward investment activities that are more discretionary and manager-driven. This pattern aligns with theoretical predictions that reduced shareholder primacy and weaker oversight allow insiders to expand firm boundaries in ways that may not maximize value.

6.2. Market Reaction to Acquisition Announcements

We next investigate the efficiency of firms' investment decisions. Regarding acquisitions, we focus on the market's response to acquisition announcements. Specifically, we use M&A announcement data from SDC Platinum and compute cumulative abnormal returns (CARs) over a [-1, +1] window (3 days) surrounding each deal announcement based on the Fama-French 3-factor plus momentum model. We then test whether the adoption of SB203 affects how the market evaluates acquisition decisions. Table 11 presents the results. Across all six specifications, the coefficient on Treat × Post is negative and statistically significant at the 1% level, with estimates ranging from -1.5% to -1.2%. These results suggest that investors respond more negatively to acquisition announcements by treated firms in the post-law period. This finding implies a deterioration in acquisition quality, reinforcing the interpretation that reduced shareholder power and weaker oversight under SB203 leads to less disciplined capital allocation.

6.3. Investment-*q* sensitivity

According to standard *q*-theory (Tobin, 1969; Hayashi, 1982), firms should increase investment when Tobin's *q* is high, as it signals favorable growth prospects and a high marginal return on capital. A strong empirical link between investment and *q* is therefore indicative of efficient capital allocation. A weakening of that link is evidence of a decrease in the efficiency of capital expenditures (Chen, Goldstein, and Jiang, 2007; McLean, Zhang, and Zhao, 2012). However, when shareholder rights are weakened and governance deteriorates, this sensitivity may weaken too. With reduced shareholder oversight, such as that induced by SB203, insiders may have greater discretion to pursue investments irrespective of their net present value, potentially due to agency motives such as empire-building. As a result, we expect that the sensitivity of investment to Tobin's *q* declines following the adoption of SB203, reflecting a deterioration in investment efficiency.

To empirically investigate the impact on investment-*q* sensitivity, we use the following specification for the relevant analysis:

$$\text{Capex}_{i,t+1} = \beta_0 + \beta_1 \cdot q_{it} \times Treat_i \times Post_t + \beta_2 \cdot q_{it} \times Treat_i + \beta_3 \cdot q_{it} + \cdots + X_{it} \cdot \Gamma + \mu_i + \nu_t + \varepsilon_{i,t+1}, \quad (2)$$

where *i* is the firm index, *t* is the year index, *Capex* is capital expenditures (scaled by total assets), $q$ is Tobin's $q$, $\mu_i$ is firm fixed effects, $\nu_t$ is year fixed effects, and $\varepsilon_{i,t+1}$ is the error term. Our focus is the coefficient on the triple interaction term, $\beta_1$. A negative $\beta_1$ suggests that investment-$q$ sensitivity decreases following the adoption of SB203. Table 12 reports the results.

Column 1 shows the model without controlling firm characteristics and Column 2 shows the model with typical control variables in the investment literature. Both columns show that $\beta_1$ is negative and statistically significant at the 1% level. This indicates a notable reduction in the responsiveness of investment to Tobin's $q$ for treated firms post-SB203, consistent with a decrease in focus on maximization of shareholder wealth. For example, in Column 2, the coefficient on Tobin's $q$ ($\beta_3$) is significantly positive, suggesting that control firms' capital expenditures are positively associated with their Tobin's $q$, as expected. The coefficient on Tobin's $q$ × Treat ($\beta_2$) is not significant, which means that before SB203 treated firms had similar investment-$q$ sensitivity as that of control firms. Importantly, the coefficient on the triple interaction term Tobin's $q$ × Treat × Post ($\beta_1$) is negative and statistically significant at the 1% level, which means that compared to control firms, treated firms' investment-$q$ sensitivity decreases significantly following the adoption of SB203.[7] The decline in investment-$q$ sensitivity among treated firms supports the interpretation that SB203 impairs investment efficiency from the perspective of shareholders. These results are consistent with the prediction that the erosion of shareholder primacy weakens the alignment between investment decisions and shareholder value, leading to less efficient capital allocation.

[7] Column 2 shows that the coefficient on Treat × Post (denoted as $\beta_4$) is significantly positive. However, it does not mean that treated firms' Capex significantly increases following SB203. In this specification, the total loading on Treat × Post is ($\beta_1 \cdot \text{Tobin's } q + \beta_4$). For a firm with average Tobin's $q$ (2.325) in our sample, this total loading is still negative at -0.003.

### 6.4. R&D efficiency

We next examine how the erosion of shareholder primacy affects the efficiency of R&D expenses, an important dimension of long-term firm value creation. Unlike capital expenditures, which often involve tangible assets and clearer near-term payoffs, R&D investments are riskier, less observable, and more discretionary, making them particularly sensitive to agency conflicts and governance quality. In theory, the effect of weakened shareholder primacy on R&D efficiency could make R&D expenditures more efficient if pressures from short-termism of shareholders creates distortion. However, poorer governance could make R&D expenditures less efficient as it could lead to greater entrenchment of management, increase the cost of capital, and increase extraction of private benefits.

To test whether the weakening of shareholder primacy affects the efficiency of R&D expenditures adversely, we measure R&D efficiency by the *Research Quotient* (RQ), which is the percentage increase in a firm's revenue resulting from a 1% increase in its R&D expenses (Knott, 2008). A reduction in RQ would indicate that R&D becomes less effective, consistent with a decline in innovation efficiency under weakened shareholder primacy. The test specification follows Equation (1) with RQ as the dependent variable.

Table 13 reports how the efficiency of R&D expenses changes in response to the adoption of SB203. In both specifications, the coefficient on the interaction term Treat × Post is negative and statistically significant at the 1% level, indicating a reduction in RQ of 17% of its sample mean of 0.077. The findings suggest that while the level of R&D spending increases, as shown in earlier analysis, the effectiveness of those expenses deteriorates after shareholder primacy weakens. These results are consistent with the prediction that weakened shareholder primacy can lead to a less efficient allocation of innovative capital, and thus lower innovation efficiency.

## 7. Conclusion

This paper studies the consequences of weakening shareholder primacy by examining the adoption of Nevada Senate Bill 203 as a quasi-natural experiment. Using a difference-in-differences design, we show

that the adoption of the law results in a significant decrease in the quality of governance and a decrease in the sensitivity of managerial compensation to changes in shareholder wealth. We find that, as a result, the law's passage leads to a significant and persistent decline in firm value. The law led to changes in investment policy. We find that capital expenditures fall, R&D expenses increase, and acquisitions increase. However, more importantly, acquisitions have a worse impact on firm value after the adoption of the Bill and the efficiency of both capital expenditures and R&D falls. Though officers and directors are allowed to take into account the interests of non-shareholder stakeholders, we find that ESG performance deteriorates across all dimensions, suggesting that broader discretion for directors and officers does not translate into stakeholder gains.

In sum, our findings provide robust evidence that weakening shareholder primacy imposes real costs on firms. Our results speak to ongoing debates in corporate governance and legal scholarship about the appropriate objectives of the firm, suggesting that shareholder primacy plays a central role in supporting accountability, efficiency, and value creation. Future reforms that shift fiduciary duties of directors and officers in a way that reduces their duties to shareholders need carefully consider these unintended consequences. While many observers and corporate governance experts argue for a stakeholder model of governance and for giving more tools to directors and officers to resist short-termism pressures by shareholders, our evidence suggests that such tools may not result in directors and officers paying more attention to stakeholders and to the firm's long-term interests than the model of shareholder primacy.

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**Appendix: Variable Definitions**

Tobin's $q$ – sum of shares outstanding multiplied by price per share plus the book value of debt all scaled by total book assets

Log(Assets) – natural logarithm of total book assets

Debt/Assets – short and long term debt scaled by total book assets

Cash/Assets – cash and short term equivalents scaled by total book assets

Capex – capital expenditures scaled by total book assets

R&D – research and development expenditures scaled by total book assets

Acquisition – acquisition expenses scaled by total book assets

Asset Sale – asset sales scaled by total book assets

DiverseAcq – a dummy variable equal to one if a firm made a diverse acquisition in a year and zero otherwise, where a diverse acquisition refers to one with acquirer and target in different industries given in SDC.

Segments – number of business segments within the firm-year

ESG – modified ESG score for a firm-year

E Score – Environmental score for a firm-year

S Score – Societal score for a firm-year

G Score – Governance score for a firm-year

Log(TDC1) – natural logarithm of total CEO compensation (in 1000s)

Log(Delta) – natural logarithm of total CEO delta (in 1000s) calculated as in Coles, Daniel, Naveen (2006)

Age60 – dummy variable equal to one if a CEO is older than 59 and zero otherwise

Return – Annual stock return over the previous fiscal year based on data from Compustat

Analysts – number of analysts covering the firm within a firm-year

E-Index – entrenchment index calculated following Bebchuk, Cohen, and Farrell (2009)

Board Ind – board independence calculated as the number of independent directors scaled by total directors

%Busy – percent of a firm's directors that are "busy" where busy director is one that serves on at least two outside boards

Bad Attendance – dummy variable equal to one if any of a firm's directors have bad attendance in a firm-year, where bad attendance is defined as missing at least 25% of a firm's board meetings within a year

Securities Lawsuit – dummy variable equal to one if the firm experiences a securities lawsuit in a given year and zero otherwise where a securities lawsuit is a legal action taken by investors against a company or its executives for violations of securities laws that often arise when investors believe they have suffered

financial losses due to misleading statements, fraud, or other wrongful actions related to the buying or selling of securities

Auditor Concern – dummy variable equal to one if the firm's auditor raises a concern about the firm in a given year and zero otherwise, where an auditor concern means the auditor has identified issues that could impact the firm's financial health or its ability to continue operating

Impairment – dummy variable equal to one if a firm has an impairment/write-off in a given year and zero otherwise, where impairment is defined as a permanent reduction in the value of its assets

SEC Letter – dummy variable equal to one if the firm receives an SEC Comment Letter within a fiscal year and zero otherwise where SEC Comment Letter is correspondence from the SEC's Corporate Finance Division typically requiring the firm to submit additional information to be in compliance with SEC disclosure and accounting requirements

%InstTotal – percent of firm's shares outstanding held by institutions

%Block – fraction of firm's shares held by block owners (>5%)

%NonBlock – fraction of firm's shares held by nonblock owners (<5%)

InstTurn – institutional investor turnover following Gaspar, Massa, and Matos (2005)

IncEIndex – dummy variable equal to one if the increase in the E-Index is above the median and zero otherwise, where the increase is the post-adoption average minus the pre-adoption average, and then scaled by the pre-adoption average.

IncBdInd – dummy variable equal to one if the increase in board independence is above the median and zero otherwise, where the increase is the post-adoption average minus the pre-adoption average and then scaled by the pre-adoption average.

IncBusy – dummy variable equal to one if the increase in the %Busy is above the median and zero otherwise, where the increase is the post-adoption average minus the pre-adoption average, and then scaled by the pre-adoption average.

IncBadAttend – dummy variable equal to one if bad attendance does not exist before the adoption but appears after adoption, and zero otherwise.

**Figure 1. Number of Firms by State of Incorporation**

This figure illustrates the number of firms by incorporation state for the top 5 states in the US across our sample period 2015-2019 (event year excluded). The data on states of incorporation is from SEC 10K filings. The right vertical axis is for Delaware (DE). The left vertical axis is for the remaining four states, with the second largest state by numbers of incorporated firms as Nevada (NV) in red.

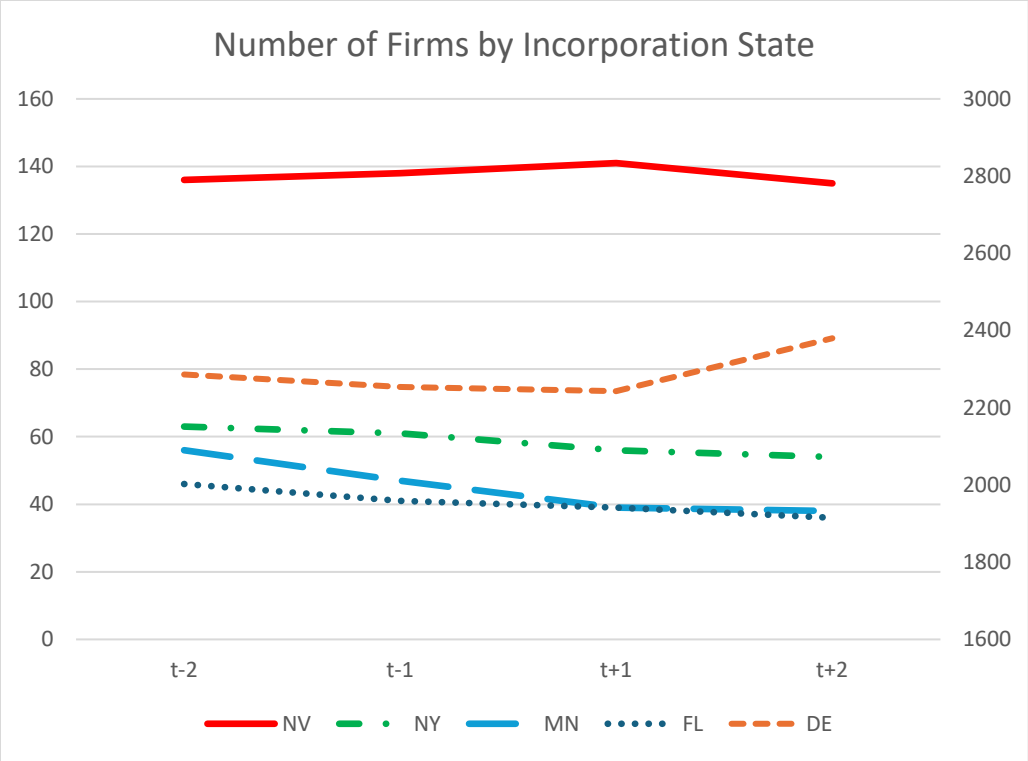

**Figure 2. Parallel Trends Figure for the Treatment Effect on Tobin's *q***

This figure illustrates the dynamic treatment effect of SB203 on firm value. Tobin's *q* is regressed on year indicator variables (relative to the event year) and controls and firm and year fixed effects included (the same setting as Table 3, Specification 3). The y-axis plots the coefficient estimates on each year indicator variable. The x-axis shows the time relative to the event year. Year t-1 is the benchmark year. The sample is from 2015 to 2019 and the event year is excluded. The error bars illustrate the 95% confidence intervals of the coefficient estimates. The confidence intervals are based on standard errors clustered at the state level.

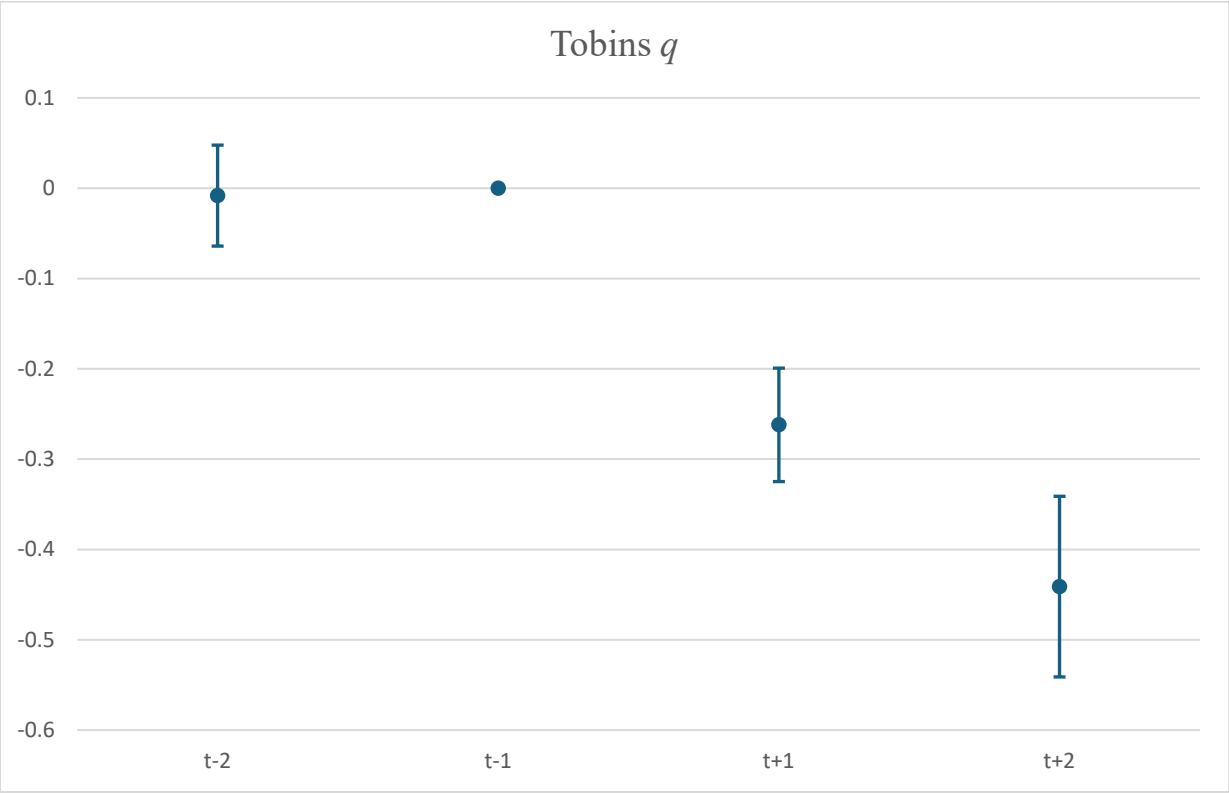

**Table 1. Comparison Between Nevada vs. Non-Nevada Firms**

This table presents the sample means of the main variables in analysis for Nevada and non-Nevada firms separately in the year before the law adoption (i.e., 2016). Column 3 reports the differences in the means, where ***, **, * denote significance for the *t*-tests at the 1%, 5%, and 10% levels, respectively. Data is from Compustat. Variables (except dummies) are winsorized at the 1st and 99th percentile values. Variable definitions are in the Appendix.

| Variable | (1)<br>Nevada | (2)<br>Non-Nevada | (3)<br>(1) – (2) |
|---|---|---|---|
| Tobin's *q* | 3.236 | 2.233 | 1.003*** |
| Log(Assets) | 4.550 | 6.579 | -2.029*** |
| Debt/Assets | 0.233 | 0.261 | -0.028 |
| Cash/Assets | 0.237 | 0.233 | 0.004 |
| Acquisition | 0.010 | 0.025 | -0.015*** |
| DiverseAcq | 0.071 | 0.188 | -0.117*** |
| Impairment | 0.097 | 0.201 | -0.104*** |
| Segments | 1.451 | 1.688 | -0.237** |
| Asset Sale | 0.005 | 0.002 | 0.003*** |
| Capex | 0.050 | 0.040 | 0.010** |
| RD | 0.063 | 0.072 | -0.009 |
| Research Quotient | 0.109 | 0.084 | 0.025 |
| Firm Age | 14.309 | 21.688 | -7.379*** |
| E-index | 2.857 | 2.630 | 0.227 |
| %Busy | 0.060 | 0.085 | -0.025 |
| BadAttend | 0.000 | 0.048 | -0.048 |
| Board Ind | 0.765 | 0.804 | -0.039 |
| Securities Lawsuit | 0.018 | 0.049 | -0.031 |
| Auditor Concern | 0.168 | 0.027 | 0.141*** |
| SEC Letter | 0.398 | 0.441 | -0.043 |
| %InstTotal | 0.538 | 0.748 | -0.210*** |
| %Block | 0.217 | 0.289 | -0.072*** |
| %NonBlock | 0.322 | 0.458 | -0.136*** |
| Analysts | 5.722 | 9.165 | -3.443*** |
| ESG Score | 43.143 | 44.136 | -0.993 |
| E Score | 36.714 | 41.072 | -4.358 |
| S Score | 33.714 | 35.807 | -2.093 |
| G Score | 54.143 | 52.466 | 1.677 |

## Table 2. Internal Corporate Governance

This table presents the effect of SB203 on corporate governance. *E-Index* is the entrenchment index following Bebchuk, Cohen, and Ferrell (2009). *%Busy* is the fraction of directors who have more than two outside board seats. *Bad Attendance* is a dummy variable equal to one if a director misses more than 25% of the board meetings within a year and zero otherwise. *Board Ind* is board independence measured by the number of independent directors scaled by total directors. *Treat* is a dummy variable equal to one if a firm is incorporated in Nevada and zero otherwise. *Post* is a dummy variable equal to one after SB203 and zero otherwise. All specifications include firm and year fixed effects. Standard errors are clustered at the state of incorporation and reported in brackets. The sample is from 2015 to 2019 and the event year is excluded. ***, **, * denote significance at the 1%, 5%, and 10% levels, respectively. Variable definitions are in the Appendix.

| | (1) | (2) | (3) | (4) |
|---|---|---|---|---|
| VARIABLES | E-Index | %Busy | Bad Attendance | Board Ind |
| Treat × Post | 0.111*** | 0.006*** | 0.055*** | -0.006*** |
| | [0.035] | [0.002] | [0.005] | [0.002] |
| Log(Assets) | -0.019 | -0.008 | 0.012 | 0.000 |
| | [0.026] | [0.006] | [0.010] | [0.004] |
| Debt/Assets | 0.006 | 0.039*** | -0.013 | 0.004 |
| | [0.095] | [0.010] | [0.016] | [0.025] |
| Cash/Assets | 0.019 | -0.033** | -0.016 | 0.009 |
| | [0.090] | [0.013] | [0.043] | [0.015] |
| Tobin's *q* | 0.007 | 0.002 | 0.000 | 0.002 |
| | [0.009] | [0.001] | [0.002] | [0.001] |
| Observations | 4,039 | 3,837 | 3,838 | 3,838 |
| R-squared | 0.917 | 0.728 | 0.327 | 0.856 |
| Firm FE | Y | Y | Y | Y |
| Year FE | Y | Y | Y | Y |

## Table 3. External Governance and Monitoring

This table presents the effect of SB203 on firm-level managerial litigation risk, accounting issues, regulatory scrutiny, institutional ownership, and analyst coverage. *Securities Lawsuit* is a dummy variable equal to one if the firm has a securities lawsuit in a year and zero otherwise. Impairment (Auditor Concern, SEC Letter) is a dummy variable equal to one if a firm has an impairment/write-off (has an auditor concern, receives a SEC comment letter) in a year and zero otherwise. %InstTotal (%NonBlock, %Block) is the fraction of equity held by institutional investors (non-block institutional owners, block institutional owners). Analysts is the number of analysts covering a firm. *Treat* is a dummy variable equal to one if a firm is incorporated in Nevada and zero otherwise. *Post* is a dummy variable equal to one after SB203 and zero otherwise. All specifications include firm and year fixed effects. Standard errors are clustered at the state of incorporation and reported in brackets. The sample is from 2015 to 2019 and the event year is excluded. ***, **, * denote significance at the 1%, 5%, and 10% levels, respectively. Variable definitions are in the Appendix.

| | (1) | (2) | (3) | (4) | (5) | (6) | (7) |
|---|---|---|---|---|---|---|---|
| VARIABLES | Securities Lawsuit | Auditor Concern | SEC Letter | %InstTotal | %NonBlock | %Block | Analysts |
| Treat × Post | -0.023*** | 0.013*** | 0.126*** | -0.024*** | -0.022*** | -0.004* | -0.418** |
| | [0.003] | [0.003] | [0.014] | [0.002] | [0.001] | [0.002] | [0.168] |
| Log(Assets) | 0.028*** | -0.052*** | 0.047** | 0.100*** | 0.087*** | 0.014*** | 1.766*** |
| | [0.007] | [0.011] | [0.019] | [0.004] | [0.003] | [0.003] | [0.144] |
| Debt/Assets | -0.027 | 0.065*** | 0.068* | -0.054*** | -0.051*** | 0.002 | 0.424** |
| | [0.018] | [0.023] | [0.040] | [0.010] | [0.011] | [0.009] | [0.195] |
| Cash/Assets | -0.069*** | -0.020 | -0.002 | 0.026** | 0.013 | 0.013 | -0.935*** |
| | [0.018] | [0.014] | [0.047] | [0.011] | [0.017] | [0.010] | [0.246] |
| Tobin's *q* | -0.010*** | -0.001 | -0.000 | 0.015*** | 0.019*** | -0.005*** | 0.057** |
| | [0.002] | [0.002] | [0.004] | [0.001] | [0.001] | [0.001] | [0.025] |
| Observations | 10,726 | 10,726 | 10,726 | 7,773 | 7,773 | 7,773 | 8,094 |
| R-squared | 0.356 | 0.687 | 0.426 | 0.919 | 0.881 | 0.782 | 0.944 |
| Firm FE | Y | Y | Y | Y | Y | Y | Y |
| Year FE | Y | Y | Y | Y | Y | Y | Y |

**Table 4. CEO Compensation: Excess Pay and Incentives**

This table presents the effect of SB203 on CEO Excess Pay. *ExcessPay* is the residual in the regression of log(Total Pay) on log(Assets), debt/assets, cash/assets, Tobin's q, and stock return. *Log(Delta)* is the natural logarithm of CEO delta calculated following Coles, Daniel, and Naveen (2006). *Treat* is a dummy variable equal to one if a firm is incorporated in Navada and zero otherwise. *Post* is a dummy variable equal to one after SB203 and zero otherwise. All specifications include firm and year fixed effects. Standard errors are clustered at the state of incorporation and reported in brackets. The sample is from 2015 to 2019 and the event year is excluded. ***, **, * denote significance at the 1%, 5%, and 10% levels, respectively. Variable definitions are in the Appendix.

| | (1) | (2) |
|---|---|---|
| VARIABLES | ExcessPay | Log(Delta) |
| | | |
| Treat × Post | 0.039** | -0.297*** |
| | [0.017] | [0.017] |
| Log(Assets) | -0.114*** | 0.674*** |
| | [0.020] | [0.035] |
| Debt/Assets | -0.306*** | -0.769*** |
| | [0.046] | [0.238] |
| Cash/Assets | 0.066 | 0.057 |
| | [0.060] | [0.187] |
| Tobin's *q* | -0.025** | 0.286*** |
| | [0.010] | [0.023] |
| Return | -0.006 | 0.210*** |
| | [0.010] | [0.018] |
| Age60 | 0.007*** | 0.085*** |
| | [0.002] | [0.005] |
| | | |
| Observations | 5,204 | 4,862 |
| R-squared | 0.675 | 0.867 |
| Firm FE | Y | Y |
| Year FE | Y | Y |

## Table 5. ESG Performance

This table presents the effect of SB203 on firm-level ESG performance. *ESG* is the aggregate score that takes all three components (environmental, societal, and governance) into account. *E Score* is the environmental component's score. *S Score* is the societal component's score. *G Score* is the governance component's score. These data are from (from S&P TruCost dataset. *Treat* is a dummy variable equal to one if a firm is incorporated in Nevada and zero otherwise. *Post* is a dummy variable equal to one after SB203 and zero otherwise. All specifications include firm and year fixed effects. Standard errors are clustered at the state of incorporation and reported in brackets. The sample is from 2015 to 2019 and the event year is excluded. ***, **, * denote significance at the 1%, 5%, and 10% levels, respectively. Variable definitions are in the Appendix.

| | (1) | (2) | (3) | (4) |
|---|---|---|---|---|
| VARIABLES | ESG | E Score | S Score | G Score |
| Treat × Post | -5.276*** | -2.299*** | -4.737*** | -6.435*** |
| | [0.262] | [0.430] | [0.328] | [0.324] |
| Log(Assets) | -0.188 | -0.638 | 0.626 | -0.411 |
| | [0.789] | [1.027] | [0.858] | [0.760] |
| Debt/Assets | -0.496 | 1.543 | -0.184 | 0.415 |
| | [2.420] | [3.106] | [2.427] | [2.365] |
| Cash/Assets | 2.599 | 0.530 | 4.367** | 2.157 |
| | [1.866] | [3.638] | [2.050] | [1.755] |
| Tobin's *q* | 0.390** | 0.505* | 0.425** | 0.274 |
| | [0.183] | [0.286] | [0.207] | [0.190] |
| Observations | 2,312 | 2,312 | 2,312 | 2,312 |
| R-squared | 0.914 | 0.903 | 0.896 | 0.892 |
| Firm FE | Y | Y | Y | Y |
| Year FE | Y | Y | Y | Y |

**Table 6. Stock Market Reaction to the Adoption of Nevada Senate Bill 203**

This table presents the stock abnormal returns around and following the effective date of the Nevada law (October 1, 2017). Panel A reports the average abnormal returns using a [0,1] window. We show results using three asset pricing models: market model, Fama-French 3-factor model, and Fama-French 3-factor plus Momentum model. Factor loadings are calculated using daily data from the previous year. Following Cohn, Johnson, Liu, and Wardlaw (2024), we calculate the standard errors based on the volatility of the time series of estimates in the previous year. We use generalized least squares to calculate the average returns for pre-periods and abnormal returns. Panel B presents long-run returns (24 months) using monthly abnormal returns calculated by subtracting the firm return from a matched portfolio return calculated following Barber and Lyon (1997). *, **, and *** denote significance at the 10%, 5%, and 1% levels, respectively.

Panel A: Short-run

| Model | Mean | *p*-value |
|---|---|---|
| Market model | -0.0121 | 0.00*** |
| FF3 | -0.0155 | 0.00*** |
| FF3+Momentum | -0.0152 | 0.00*** |

Panel B: Long-run

| Weighting | Abnormal return | *p*-value |
|---|---|---|
| Equal-weighted | -0.1447 | 0.06* |
| Value-weighted | -0.1441 | 0.06* |

**Table 7. Firm Value and the Adoption of Nevada Senate Bill 203**

This table presents the effect of the Nevada Senate Bill 203 on firm value, which is measured by *Tobin's q*. *Log(q)* is the natural logarithm of Tobin's *q*. *Treat* is a dummy variable equal to one if a firm is incorporated in Nevada and zero otherwise. *Post* is a dummy variable equal to one after the law adoption and zero otherwise. All specifications include firm and year fixed effects. Standard errors are clustered at the state of incorporation and reported in brackets. The sample is from 2015 to 2019 and the event year is excluded. ***, **, * denote significance at the 1%, 5%, and 10% levels, respectively. Variable definitions are in the Appendix.

| | (1) | (2) | (3) | (4) |
|---|---|---|---|---|
| VARIABLES | Tobin's *q* | Log(*q*) | Tobin's *q* | Log(*q*) |
| Treat × Post | -0.384*** | -0.069*** | -0.340*** | -0.058*** |
| | [0.015] | [0.005] | [0.029] | [0.007] |
| Log(Assets) | | | -0.532*** | -0.160*** |
| | | | [0.113] | [0.029] |
| Debt/Assets | | | -0.237** | -0.071*** |
| | | | [0.099] | [0.025] |
| Cash/Assets | | | 0.542*** | 0.254*** |
| | | | [0.121] | [0.027] |
| Observations | 10,726 | 10,726 | 10,726 | 10,726 |
| R-squared | 0.828 | 0.859 | 0.834 | 0.865 |
| Firm FE | Y | Y | Y | Y |
| Year FE | Y | Y | Y | Y |

**Table 8. Cost of Debt: Evidence from Commercial Loan**

This table presents the effect of SB203 on the firm's cost of borrowing. *Log(Spread)* is the natural logarithm of all-in spread drawn (AISD), which is from *Dealscan* and represents the amount a borrower pays in basis points over Libor for each dollar drawn down. *Treat* is a dummy variable equal to one if a firm is incorporated in Navada and zero otherwise. Post is a dummy variable equal to one after SB203 and zero otherwise. The data is in event time (not a firm-year panel). All specifications include firm and year fixed effects. Standard errors are clustered at the state of incorporation and reported in brackets. The sample is from 2015 to 2019 and the event year is excluded. ***, **, * denote significance at the 1%, 5%, and 10% levels, respectively. Variable definitions are in the Appendix.

| | (1) | (2) | (3) |
|---|---|---|---|
| VARIABLES | Log(Spread) | Log(Spread) | Log(Spread) |
| Treat × Post | 0.045** | 0.032* | 0.066*** |
| | [0.019] | [0.017] | [0.012] |
| Log(Maturity) | | 0.090*** | 0.122*** |
| | | [0.012] | [0.010] |
| Log(Loan size) | | -0.091*** | -0.090*** |
| | | [0.007] | [0.008] |
| Log(Assets) | | | -0.062*** |
| | | | [0.023] |
| Tobin's $q$ | | | -0.008 |
| | | | [0.017] |
| Debt/Assets | | | 0.514*** |
| | | | [0.078] |
| CF Vol | | | 0.160 |
| | | | [0.366] |
| Default Prob | | | 0.001 |
| | | | [0.001] |
| CF/Assets | | | -0.668*** |
| | | | [0.152] |
| Observations | 4,331 | 4,306 | 3,988 |
| R-squared | 0.791 | 0.810 | 0.818 |
| Loan Type FE | Y | Y | Y |
| Firm FE | Y | Y | Y |
| Year FE | Y | Y | Y |

**Table 9. Impact on Firm Value: The Corporate Governance Channel**

This table presents evidence linking weaker governance with lower firm value. *IncEIndex* (*IncBusy*) is a dummy variable equal to one if the increase in the E-Index (%Busy) is above the median and zero otherwise, where the increase is the post-adoption average minus the pre-adoption average, and then scaled by the pre-adoption average. *IncBadAttend* is a dummy variable equal to one if bad attendance does not exist before the adoption but appears after adoption, and zero otherwise. *IncBdInd* is a dummy variable equal to one if the increase in board independence is above the median and zero otherwise, where the increase is the post-adoption average minus the pre-adoption average, and then scaled by the pre-adoption average. *Treat* is a dummy variable equal to one if a firm is incorporated in Nevada and zero otherwise. *Post* is a dummy variable equal to one after SB203 and zero otherwise. All specifications include firm fixed effects and year-times-gov fixed effects, where gov stands for the corresponding dummy variable defined above. Standard errors are clustered at the state of incorporation and reported in brackets. The sample is from 2015 to 2019 and the event year is excluded. ***, **, * denote significance at the 1%, 5%, and 10% levels, respectively. Variable definitions are in the Appendix.

| VARIABLES | (1)<br>Tobin's *q* | (2)<br>Tobin's *q* | (3)<br>Tobin's *q* | (4)<br>Tobin's *q* |
|---|---|---|---|---|
| Treat × Post | 0.013 | 0.013 | 0.038 | -0.212*** |
| | [0.034] | [0.034] | [0.035] | [0.049] |
| Treat × Post × IncEIndex | -0.182*** | | | |
| | [0.046] | | | |
| Treat × Post × IncBusy | | -0.182*** | | |
| | | [0.046] | | |
| Treat × Post × IncBadAttend | | | -0.470*** | |
| | | | [0.099] | |
| Treat × Post × IncBdInd | | | | 0.341*** |
| | | | | [0.031] |
| Log(Assets) | -0.626*** | -0.626*** | -0.687*** | -0.690*** |
| | [0.078] | [0.078] | [0.065] | [0.068] |
| Debt/Assets | -0.714*** | -0.714*** | -0.880*** | -0.886*** |
| | [0.204] | [0.204] | [0.199] | [0.202] |
| Cash/Assets | 0.212 | 0.212 | 0.055 | 0.083 |
| | [0.195] | [0.195] | [0.190] | [0.182] |
| Observations | 3,780 | 3,780 | 3,549 | 3,549 |
| R-squared | 0.875 | 0.875 | 0.873 | 0.873 |
| Firm FE | Y | Y | Y | Y |
| Year x Gov FE | Y | Y | Y | Y |

**Table 10. Acquisitions, Divestitures, and Internal Investments**

This table presents the effect of SB203 on firm investments. Acquisition, Asset Sale, Capex, and R&D are all scaled by total assets. *Segments* is the number of business segments. *DiverseAcq* is a dummy variable equal to one if a firm made a diverse acquisition in a year and zero otherwise, where a diverse acquisition refers to one with acquirer and target in different industries given in SDC. *Treat* is a dummy variable equal to one if a firm is incorporated in Navada and zero otherwise. *Post* is a dummy variable equal to one after SB203 and zero otherwise. All specifications include firm and year fixed effects. Standard errors are clustered at the state of incorporation and reported in brackets. The sample is from 2015 to 2019 and the event year is excluded. ***, **, * denote significance at the 1%, 5%, and 10% levels, respectively. Variable definitions are in the Appendix.

| | (1) | (2) | (3) | (4) | (5) | (6) | (7) |
|---|---|---|---|---|---|---|---|
| VARIABLES | Acquisition | DiverseAcq | Impairment | Segments | Asset Sale | Capex | R&D |
| Treat × Post | 0.004*** | 0.050*** | 0.077*** | 0.050*** | -0.002*** | -0.002*** | 0.002*** |
| | [0.001] | [0.004] | [0.005] | [0.008] | [0.000] | [0.000] | [0.000] |
| Log(Assets) | 0.037*** | 0.065*** | -0.013 | 0.094*** | -0.001*** | -0.007*** | -0.031*** |
| | [0.002] | [0.009] | [0.011] | [0.010] | [0.000] | [0.001] | [0.002] |
| Debt/Assets | 0.037*** | -0.012 | 0.141*** | -0.056 | -0.002** | -0.018*** | -0.000 |
| | [0.005] | [0.019] | [0.025] | [0.037] | [0.001] | [0.003] | [0.006] |
| Cash/Assets | -0.089*** | -0.169*** | -0.027 | -0.212** | 0.001 | -0.045*** | -0.026*** |
| | [0.008] | [0.028] | [0.036] | [0.081] | [0.001] | [0.004] | [0.006] |
| Tobin's *q* | 0.001*** | 0.009*** | -0.008*** | -0.004** | -0.000** | 0.001*** | 0.005*** |
| | [0.000] | [0.001] | [0.003] | [0.002] | [0.000] | [0.000] | [0.001] |
| CF/Assets | -0.036*** | -0.023 | -0.049*** | -0.136*** | -0.001** | 0.004 | -0.227*** |
| | [0.005] | [0.020] | [0.014] | [0.018] | [0.001] | [0.004] | [0.015] |
| Observations | 10,702 | 10,702 | 10,702 | 10,702 | 10,702 | 10,702 | 10,702 |
| R-squared | 0.432 | 0.539 | 0.534 | 0.923 | 0.646 | 0.807 | 0.931 |
| Firm FE | Y | Y | Y | Y | Y | Y | Y |
| Year FE | Y | Y | Y | Y | Y | Y | Y |

**Table 11. Market Reaction to Acquisition Announcements**

This table presents the effect of SB203 on announcement returns of acquirers. *CAR* is the 3-day abnormal return [-1, +1] around the announcement of a merger based on the Fama-French 3-factor plus momentum model. *Treat* is a dummy variable equal to one if a firm is incorporated in Nevada and zero otherwise. *Post* is a dummy variable equal to one after SB203 and zero otherwise. The announcement data is from SDC. All specifications include industry (acquirer) and year fixed effects. Standard errors are clustered at the state of incorporation and reported in brackets. The sample is from 2015 to 2019 and the event year is excluded. ***, **, * denote significance at the 1%, 5%, and 10% levels, respectively. Variable definitions are in the Appendix.

| | (1) | (2) | (3) | (4) | (5) | (6) |
|---|---|---|---|---|---|---|
| VARIABLES | CAR | CAR | CAR | CAR | CAR | CAR |
| Treat × Post | -0.012*** | -0.014*** | -0.012*** | -0.015*** | -0.012*** | -0.014*** |
| | [0.001] | [0.002] | [0.001] | [0.002] | [0.001] | [0.002] |
| Log(Assets) | | | -0.004*** | -0.005*** | -0.004*** | -0.005*** |
| | | | [0.000] | [0.000] | [0.000] | [0.000] |
| Debt/Assets | | | 0.020*** | 0.022*** | 0.020*** | 0.022*** |
| | | | [0.006] | [0.008] | [0.007] | [0.008] |
| Cash/Assets | | | 0.029*** | 0.031*** | 0.028*** | 0.030*** |
| | | | [0.006] | [0.008] | [0.006] | [0.008] |
| Tobin's *q* | | | -0.001*** | -0.001* | -0.001*** | -0.001 |
| | | | [0.000] | [0.001] | [0.000] | [0.001] |
| CashDeal | | | | | 0.011*** | 0.010*** |
| | | | | | [0.001] | [0.001] |
| DiverseAcq | | | | | 0.001 | -0.001 |
| | | | | | [0.002] | [0.002] |
| Observations | 7,654 | 7,652 | 7,642 | 7,640 | 7,446 | 7,444 |
| R-squared | 0.001 | 0.009 | 0.017 | 0.026 | 0.021 | 0.030 |
| Industry FE | N | Y | N | Y | N | Y |
| Year FE | Y | Y | Y | Y | Y | Y |

## Table 12. Investment-*q* Sensitivity

This table presents the effect of SB203 on investment-*q* sensitivity following Chen, Goldstein, and Jiang (2007). *Capex* is capital expenditures (scaled by assets). *Treat* is a dummy variable equal to one if a firm is incorporated in Navada and zero otherwise. *Post* is a dummy variable equal to one after SB203 and zero otherwise. All specifications include firm and year fixed effects. Standard errors are clustered at the state of incorporation and reported in brackets. The sample is from 2015 to 2019 and the event year is excluded. ***, **, * denote significance at the 1%, 5%, and 10% levels, respectively. Variable definitions are in the Appendix.

| | (1) | (2) |
|---|---|---|
| VARIABLES | Capex | Capex |
| Tobin's *q* × Treat × Post | -0.004*** | -0.004*** |
| | [0.000] | [0.000] |
| Tobin's *q* × Treat | 0.001* | 0.001 |
| | [0.000] | [0.001] |
| Tobin's *q* | 0.003*** | 0.002*** |
| | [0.000] | [0.000] |
| Treat x Post | 0.006*** | 0.006*** |
| | [0.001] | [0.001] |
| Log(Assets) | | -0.003*** |
| | | [0.001] |
| Debt/Assets | | -0.025*** |
| | | [0.003] |
| Cash/Assets | | 0.011*** |
| | | [0.004] |
| CF/Assets | | 0.000 |
| | | [0.003] |
| Observations | 10,534 | 10,515 |
| R-squared | 0.797 | 0.800 |
| Firm FE | Y | Y |
| Year FE | Y | Y |

**Table 13. R&D Efficiency**

This table presents the effect of SB203 on firms' R&D efficiency. *Research Quotient (RQ)* is the percentage increase in a firm's revenue resulting from a 1% increase in its R&D expenditure (Knott, 2008). *Treat* is a dummy variable equal to one if a firm is incorporated in NV and zero otherwise. *Post* is a dummy variable equal to one after SB203 and zero otherwise. All specifications include firm and year fixed effects. Standard errors are clustered at the state of incorporation and reported in brackets. The sample is from 2015 to 2019 and the event year is excluded. ***, **, * denote significance at the 1%, 5%, and 10% levels, respectively. Variable definitions are in the Appendix.

| | (1) | (2) |
|---|---|---|
| VARIABLES | RQ | RQ |
| | | |
| Treat × Post | -0.013*** | -0.013*** |
| | [0.001] | [0.001] |
| Log(Assets) | | 0.003** |
| | | [0.001] |
| Debt/Assets | | -0.009 |
| | | [0.007] |
| Cash/Assets | | -0.000 |
| | | [0.004] |
| Tobin's *q* | | -0.000 |
| | | [0.000] |
| | | |
| Observations | 3,734 | 3,707 |
| R-squared | 0.803 | 0.807 |
| Firm FE | Y | Y |
| Year FE | Y | Y |

# Internet Appendix

**Table IA1. Robustness Tests on Firm Value: Various Fixed Effects and Total *q* as an Alternative Measure of Firm Value**

This table presents the effect of SB203 on firm value using alternate fixed effects as robustness tests. *Log(q)* is the natural logarithm of Tobin's *q*. *Treat* is a dummy variable equal to one if a firm is incorporated in Navada and zero otherwise. *Post* is a dummy variable equal to one after the law adoption and zero otherwise. Panel A uses firm and industry-year fixed effects. Panel B uses firm and year-size, year-leverage, and year-cash fixed effects. Panel C reports the tests using total *q* (Peters and Taylor, 2017) as an alternative measure of firm value with various fixed effects. Firms with Total *q* above 20 are excluded. Specifically, the relevant interacted variables for fixed effects are split into quartiles in the year before SB203 and then the fixed effects are based on those quartiles. Standard errors are clustered at the state of incorporation and reported in brackets. The sample is from 2015 to 2019 and the event year is excluded. ***, **, * denote significance at the 1%, 5%, and 10% levels, respectively. Variable definitions are in the Appendix.

Panel A. Industry-year fixed effects

| | (1) | (2) | (3) | (4) |
|---|---|---|---|---|
| VARIABLES | Tobin's *q* | Log(*q*) | Tobin's *q* | Log(*q*) |
| Treat × Post | -0.373*** | -0.066*** | -0.319*** | -0.052*** |
| | [0.017] | [0.006] | [0.025] | [0.009] |
| Log(Assets) | | | -0.550*** | -0.166*** |
| | | | [0.104] | [0.026] |
| Debt/Assets | | | -0.174 | -0.033 |
| | | | [0.107] | [0.024] |
| Cash/Assets | | | 0.586*** | 0.268*** |
| | | | [0.121] | [0.027] |
| Observations | 10,712 | 10,712 | 10,712 | 10,712 |
| R-squared | 0.833 | 0.867 | 0.840 | 0.873 |
| Firm FE | Y | Y | Y | Y |
| Ind-Year FE | Y | Y | Y | Y |

Panel B: Other fixed effects

| VARIABLES | (1) Tobin's $q$ | (2) Log($q$) | (3) Tobin's $q$ | (4) Log($q$) |
|---|---|---|---|---|
| Treat × Post | -0.287*** | -0.064*** | -0.243*** | -0.052*** |
| | [0.028] | [0.009] | [0.036] | [0.009] |
| Log(Assets) | | | -0.552*** | -0.166*** |
| | | | [0.105] | [0.028] |
| Debt/Assets | | | -0.300*** | -0.090*** |
| | | | [0.103] | [0.026] |
| Cash/Assets | | | 0.819*** | 0.349*** |
| | | | [0.118] | [0.027] |
| Observations | 10,446 | 10,446 | 10,446 | 10,446 |
| R-squared | 0.825 | 0.859 | 0.833 | 0.867 |
| Firm FE | Y | Y | Y | Y |
| Year-Size FE | Y | Y | Y | Y |
| Year-Leverage FE | Y | Y | Y | Y |
| Year-Cash FE | Y | Y | Y | Y |

Panel C: Total $q$ as an alternative measure of firm value

| VARIABLES | (1) Total $q$ | (2) Total $q$ | (3) Total $q$ | (4) Total $q$ | (5) Total $q$ | (6) Total $q$ |
|---|---|---|---|---|---|---|
| Treat × Post | -0.174*** | -0.221*** | -0.144*** | -0.185*** | -0.159*** | -0.174*** |
| | [0.019] | [0.016] | [0.015] | [0.024] | [0.027] | [0.028] |
| Log(Assets) | | 0.234** | | 0.220** | | 0.221* |
| | | [0.115] | | [0.107] | | [0.113] |
| Debt/Assets | | -0.701*** | | -0.654*** | | -0.617*** |
| | | [0.104] | | [0.125] | | [0.106] |
| Cash/Assets | | 1.755*** | | 1.707*** | | 1.923*** |
| | | [0.173] | | [0.174] | | [0.142] |
| Observations | 10,435 | 10,435 | 10,417 | 10,417 | 10,242 | 10,242 |
| R-squared | 0.804 | 0.810 | 0.813 | 0.819 | 0.807 | 0.814 |
| Firm FE | Y | Y | Y | Y | Y | Y |
| Year FE | Y | Y | N | N | N | N |
| Ind-Year FE | N | N | Y | Y | N | N |
| Year-Size FE | N | N | N | N | Y | Y |
| Year-Leverage FE | N | N | N | N | Y | Y |
| Year-Cash FE | N | N | N | N | Y | Y |

**Table IA2. PSM Approach: Firm Value and the Adoption of Nevada Senate Bill 203**

This table presents the effect of SB203 on firm value when using a propensity score matched (PSM) sample of control firms. *Log(q)* is the natural logarithm of Tobin's *q*. *Treat* is a dummy variable equal to one if a firm is incorporated in Navada and zero otherwise. *Post* is a dummy variable equal to one after the law adoption and zero otherwise. We uses up to 5 control firms matched industry and firm size (book value of total assets). The PSM in is done in the year before SB203. Standard errors are clustered at the state of incorporation and reported in brackets. The sample is from 2015 to 2019 and the event year is excluded. ***, **, * denote significance at the 1%, 5%, and 10% levels, respectively. Variable definitions are in the Appendix.

| | (1) | (2) | (3) | (4) |
|---|---|---|---|---|
| VARIABLES | Tobin's *q* | Log(*q*) | Tobin's *q* | Log(*q*) |
| Treat × Post | -0.454*** | -0.077*** | -0.431*** | -0.069*** |
| | [0.113] | [0.027] | [0.088] | [0.022] |
| Log(Assets) | | | -0.500* | -0.160*** |
| | | | [0.280] | [0.044] |
| Debt/Assets | | | 0.547* | 0.187** |
| | | | [0.282] | [0.084] |
| Cash/Assets | | | 0.825*** | 0.335*** |
| | | | [0.175] | [0.071] |
| Observations | 1,811 | 1,811 | 1,811 | 1,811 |
| R-squared | 0.838 | 0.862 | 0.842 | 0.868 |
| Firm FE | Y | Y | Y | Y |
| Year FE | Y | Y | Y | Y |

**Table IA3. Robustness Tests: Excluding Lobbying Firms or Firms Headquartered and Incorporated in the Same State**

This table presents robustness tests for the treatment effect on firm value. *Log(q)* is the natural logarithm of Tobin's *q*. *Treat* is a dummy variable equal to one if a firm is incorporated in Nevada and zero otherwise. *Post* is a dummy variable equal to one after the law adoption and zero otherwise. Panel A excludes firms that are headquartered and incorporated in the same state. Panel B excludes firms that lobbied in Nevada in 2021 (earliest data available at www.leg.state.nv.us). Standard errors are clustered at the state of incorporation and reported in brackets. The sample is from 2015 to 2019 and the event year is excluded. ***, **, * denote significance at the 1%, 5%, and 10% levels, respectively. Variable definitions are in the Appendix.

Panel A: Exclude firms headquartered and incorporated in the same state

| | (1) | (2) | (3) | (4) |
|---|---|---|---|---|
| VARIABLES | Tobin's *q* | Log(*q*) | Tobin's *q* | Log(*q*) |
| Treat × Post | -0.578*** | -0.099*** | -0.531*** | -0.086*** |
| | [0.009] | [0.002] | [0.016] | [0.004] |
| Log(Assets) | | | -0.462*** | -0.140*** |
| | | | [0.064] | [0.014] |
| Debt/Assets | | | -0.253*** | -0.066*** |
| | | | [0.065] | [0.019] |
| Cash/Assets | | | 0.404*** | 0.238*** |
| | | | [0.050] | [0.016] |
| Observations | 8,380 | 8,380 | 8,380 | 8,380 |
| R-squared | 0.820 | 0.854 | 0.825 | 0.859 |
| Firm FE | Y | Y | Y | Y |
| Year-Size FE | Y | Y | Y | Y |
| Year-Leverage FE | Y | Y | Y | Y |
| Year-Cash FE | Y | Y | Y | Y |

Panel B. Exclude Nevada lobbying firms

| | (1) | (2) | (3) | (4) |
|---|---|---|---|---|
| VARIABLES | Tobin's *q* | Log(*q*) | Tobin's *q* | Log(*q*) |
| Treat × Post | -0.379*** | -0.064*** | -0.334*** | -0.053*** |
| | [0.015] | [0.005] | [0.029] | [0.007] |
| Log(Assets) | | | -0.532*** | -0.160*** |
| | | | [0.113] | [0.029] |
| Debt/Assets | | | -0.238** | -0.072*** |
| | | | [0.099] | [0.025] |
| Cash/Assets | | | 0.542*** | 0.254*** |
| | | | [0.121] | [0.027] |
| Observations | 10,720 | 10,720 | 10,720 | 10,720 |
| R-squared | 0.828 | 0.859 | 0.834 | 0.865 |
| Firm FE | Y | Y | Y | Y |
| Ind-Year FE | Y | Y | Y | Y |