

Report Type

End-of-Term Award Report

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Cambridge Endowment for Research in Finance (CERF)

Project Title

Research in Corporate Governance and Innovation

Project Start Date

Jul 02, 2018

Project End Date

Jul 02, 2020

Project Abstract

In this project, I study the corporate value implications of corporate governance mechanisms and product market competition, as well as, the capital structure effects of knowledge-based intangibility. With the first paper “Shadow Pills and Long-Term Firm Value” I investigate whether the right to adopt a poison pill (where the *right* constitutes the shadow pill) is value relevant for shareholders. In the second paper “Product Market Competition and Long-Term Firm Value: Evidence from Reverse Engineering Laws” I analyze the effect of decreased competition (brought about by a change in intellectual property protection) on the value of a corporation. The third paper “Stakeholder Orientation and Firm Value” explores the value impact of expanded director authority to consider the interests of all stakeholders of the firm. In the fourth paper “Keeping Secrets from Creditors: The Uniform Trade Secrets Act and Financial Leverage” I examine the relation between a firm’s financing decisions and a shift towards increased intangibility in the form of trade secrets.

Activities and Achievement

1. Shadow Pills and Long-Term Firm Value

This paper finds that the *right to adopt* a poison pill (i.e., “shadow pill”) is value increasing for shareholders. Moreover, the positive value effect is differentially higher for firms more engaged in innovative projects or with important stakeholder relationships. This finding is consistent with the bonding hypothesis of takeover defenses. These results provide the first empirical support that while the endogenous decision to adopt a poison pill is negatively correlated with value, exogenous increases in the right to adopt a poison pill (strength of the shadow pill) is beneficial to shareholders. This paper was awarded the AEFIN “Best paper of the Conference” by the Spanish Finance Association at the 26th Finance Forum.

2. Product Market Competition and Long-Term Firm Value: Evidence from Reverse Engineering Laws

This paper documents that a decrease in the intensity of competition in product markets is value enhancing for shareholders. This is especially so for firms with greater innovative ability. These findings provide the first causal evidence that (1) decreased competition leads to higher corporate value (not just an association), and (2) that the value increases are not simply attributable to standalone economics rents (from market power), but rather it is the use of rents for investments in new and existing production technologies (i.e., innovation incentives) that creates value.

3. Stakeholder Orientation and Firm Value

This paper shows that the enhancement of director discretion to consider the interests of all stakeholders (“stakeholder orientation”) leads to increases in corporate valuation. In addition, it is found that the increases in value are more pronounced for larger and more complex firms, firms more exposed to endogenous uncertainty and with important stakeholder relationships. These results are consistent with the bonding hypothesis of takeovers and the stakeholder model hypothesis. These empirical findings are important for (1) policy makers as it suggests that the shareholder-centric view of the firm might be less than optimal for total welfare in certain environments and (2) opens important avenues for future research.

4. Keeping Secrets from Creditors: The Uniform Trade Secrets Act and Financial Leverage

This paper considers how a growing reliance on knowledge-based intangibles in the form of trade secrets by most U.S. firms affects capital structure decisions. The key finding is that stronger trade secrets protection results in significant reductions in financial leverage for the affected firms. Consistent with an economic mechanism that largely works through the limited pledgeability of trade secrets, the paper finds the decreases in debt ratios are more pronounced for firms more ex-ante reliant on secrecy, and that enhanced trade secrets protection magnifies contractibility problems with creditors by incentivizing new investments in intangible-based assets and investment opportunities, decreasing asset liquidation values and disincentivizing the use of patents to protect knowledge.

Dissemination

1. Shadow Pills and Long-Term Firm Value

This paper will be submitted to a top-3 finance journal within the next two weeks. This paper is also featured as a *European Corporate Governance Institute (ECGI) – Finance Working Paper (No. 595/2019)*.

Conference presentations: Southwest Finance Symposium (April 2018), Accounting and Finance Conference (May, 2018)*, American Law and Economics Association (May 2018)*, SFS Cavalcade North America (May 2018)*, 26th Finance Forum (July 2018), FMA (October 2018), Paris December Finance Meeting (December 2018), Midwest Finance Association (March 2019)*.

Seminar presentations: Toulouse School of Economics (December 2017)*, New York University (January 2018)*, University of Oklahoma (February 2018), University of Alabama (October 2018)*, University of Illinois at Chicago (December 2018)*, Texas Christian University (April 2019)*.

2. Product Market Competition and Long-Term Firm Value: Evidence from Reverse Engineering Laws

This paper will be submitted to a top-3 finance journal by the end of May.

Conference presentations: 2nd TILEC (Tilburg University) conference on Competition, Standardization and Innovation, Southwestern Finance Association Annual Meeting (March 2018), 6th Annual Research Roundtable (Northwestern University) on Standard Setting Organizations and Patents (May 2018), 26th Finance Forum (July 2018), FMA (October 2018), Paris Financial Management Association (December 2018), American Law and Economics Annual Meeting (May 2019, scheduled).

Seminar presentations: University of Oklahoma (January 2018), University of Cambridge (October 2018).

3. Stakeholder Orientation and Firm Value

This paper is under review at a top-3 finance journal.

Conference presentations: American Finance Association (January 2019) *, NBER Law and Economics Program (February 2019) *, Adam Smith Corporate Finance Workshop (March 2019), SFS Cavalcade North America (May 2019, scheduled), FMA Europe (June 2019, scheduled).

Seminar presentations: University of Pennsylvania (February 2018) *, University of California at Los Angeles (March 2018) *, University of Cambridge (February 2019), HEC Paris (March 2019) *.

4. Keeping Secrets from Creditors: The Uniform Trade Secrets Act and Financial Leverage
This paper will be submitted to a top-3 finance journal within the next week.
Conference presentations: 2019 European Strategy, Entrepreneurship and Innovation (SEI) Faculty Workshop (May 2019, scheduled).
Seminar presentations: University of Cambridge (March 2019), University of Oklahoma (March 2019) *.

** Presented by co-author*

Outputs

1. Shadow Pills and Long-Term Firm Value
Abstract: This paper analyzes the value impact of the right to adopt a poison pill – or “shadow pill” – on long-term firm value, exploiting the quasi-natural experiment provided by the staggered adoption of poison pill laws that validated the use of the pill in 35 U.S. states over the period 1986 to 2009. We document that the availability of a shadow pill results in an economically and statistically significant increase in firm value, especially for firms more engaged in innovation or with stronger stakeholder relationships. Our findings are robust to matching, higher dimensional fixed effects and portfolio analysis, and support the bonding hypothesis of takeover defenses.
2. Product Market Competition and Long-Term Firm Value: Evidence from Reverse Engineering Laws
Abstract: I analyze the value impact of product market competition (PMC) on long-term firm value. Using exogenous state adoption of anti-plugin-mold statutes, and their subsequent invalidation, I causally show that decreased PMC generates economically and statistically significant long-term firm value, especially for firms at heightened risk of product imitation or with greater innovative ability. My findings are robust to an array of falsification tests directly aimed at ruling out the possibility of unobserved sources of local variation confounding the analysis and provide support for the view that a reduction in PMC leads to higher firm value by increasing innovation incentives.
3. Stakeholder Orientation and Firm Value
Abstract: This paper analyzes the relation between enhanced director discretion to consider stakeholder interests (“stakeholder orientation”) and firm value by considering the quasi-natural experiment provided by the staggered adoption of directors’ duties laws in 35 U.S. states from 1984 to 2006. We find that these laws result in significant increases in shareholder value, especially for firms that are larger, more complex or innovative and with stronger stakeholder relationships. Our results suggest that stakeholder orientation creates value for some firms by reducing contracting costs with stakeholders and mitigating the externalities stakeholders may bear due to conflicts of interests with shareholders.
4. Keeping Secrets from Creditors: The Uniform Trade Secrets Act and Financial Leverage

Abstract: This paper examines the impact of trade secrets protection on capital structure, exploiting the quasi-natural experiment provided by the staggered adoption of the Uniform Trade Secrets Act (UTSA) which codified protection of trade secrets in 46 U.S. states from 1980 to 2013. We document that enhanced trade secrets protection results in significant reductions in financial leverage, especially for firms more ex-ante reliant on secrecy. We also find the UTSA leads to more secrecy by incentivizing investments in intangibles and away from patents. Our findings support the asset pledgeability hypothesis in which greater firm intangibility magnifies contractibility problems with creditors.

Major Difficulties and Any Other Issues

None.

Web Links

1. Shadow Pills and Long-Term Firm Value
Web link: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3074658
2. Product Market Competition and Long-Term Firm Value: Evidence from Reverse Engineering Laws
Web link: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3074622
3. Stakeholder Orientation and Firm Value
Web link: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3299889
4. Keeping Secrets from Creditors: The Uniform Trade Secrets Act and Financial Leverage
Web link: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3063466

Additional Information

Declaration

This award has not yet produced any relevant outputs, but details of any future publications will be submitted to the CERF database as soon as they become available.

1. Shadow Pills and Long-Term Firm Value

This is joint work with Martijn Cremers, Lubomir Litov and Simone Sepe.

2. Product Market Competition and Long-Term Firm Value: Evidence from Reverse Engineering Laws

This is a sole-authored project.

3. Stakeholder Orientation and Firm Value

This is joint work with Martijn Cremers and Simone Sepe.

4. Keeping Secrets from Creditors: The Uniform Trade Secrets Act and Financial Leverage

This is joint work with Kose John and Lubomir Litov.