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# THE EFFECT OF WEAKENING OF CORPORATE GOVERNANCE ON ENTREPRENEURSHIP

Pankaj Khandelwal [1]

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## ABSTRACT

This paper examines the effect of the weakening of corporate governance on entrepreneurship. The paper argues that weakening corporate governance facilitates the rent extraction by management, increasing the potential benefits of entrepreneurship in the event of success. We hypothesise that this should increase the entry of firms in states with weaker corporate governance provisions. We test this hypothesis using the passage of anti−takeover laws by states that weaken corporate governance by shielding management from hostile takeovers. The preliminary results provided in the paper support this hypothesis.

**Keywords:** Corporate Governance, Entrepreneurship, Anti-Takeover Laws

## 1. INTRODUCTION

The importance of adequate Corporate Governance regulations cannot be overemphasized for any economy. By ensuring that the providers of funds to corporations get a return on their investments, corporate governance helps corporations to raise these funds in the first place. The stronger the corporate governance provisions, the easier it is for the public to get returns on their funds, and thus, the public is more willing to supply funds to the corporations (see Shleifer and Vishny 1997 for a survey). Given the critical role played by financial capital in corporations, it is therefore argued that corporate governance is necessary for the development of the corporate sector and the stronger the corporate governance, the better it is for the economy. The success of any economy in general and the corporate sector in particular depends substantially on how well it solves the corporate governance problem.

## 1.1. FINANCIAL LITERATURE IS REPLETE WITH PAPERS DOCUMENTING THE POSITIVE

benefits of strong corporate governance provisions. Gompers, Ishii and Metrick (2003) showed that higher shareholder rights are associated with an increase in firm value, profit, and sales along with a decrease in capital expenditure. Their work was followed by a large literature showing positive effects of corporate governance. Along the similar lines, it is showed that Business Combination laws passed by the states that led to the weakening of the corporate governance by putting restrictions on hostile takeovers were associated with an overall decline in productivity and profitability along with increase in worker wages (Bertrand and Mullainathan (2003); Giroud and Miller (2010)). This

literature has led us to believe that corporate governance provisions are a boon to the economy, and the stronger the corporate governance provisions, the better it is. While it's hard to argue with the former, I have some serious reservations about the latter.

## 1.2. THE REASON IS THAT THE DEVELOPMENT OF THE CORPORATE SECTOR DEPENDS NOT ONLY ON

the supply of funds but also on the supply of entrepreneurial talent. It is important to note that entrepreneurship is a risky business and it may not be worth starting a new firm unless the potential entrepreneurs expect to receive substantially high gains in the future to compensate them for the risk. Strong corporate governance provisions make it difficult for entrepreneurs to extract rents above their current opportunity cost after the firm successfully goes public. By doing so, it discourages potential entrepreneurs from starting up a firm, thus decreasing the supply of entrepreneurial talent. Therefore, even though stronger corporate governance laws may increase the supply of funds to the existing firms, they may still have an overall negative impact on the economy by reducing the supply of entrepreneurial talent and hence, reducing the number of startups. Thus, there is a trade-off involved in choosing external corporate governance provisions by the state: Stronger corporate governance provisions help existing corporations raise funds easily by increasing the supply of funds, but they may also reduce the entry of new firms ex-ante due to the weakening of incentives faced by potential entrepreneurs. The corporate governance literature so far has focused mainly on the former, but it is not hard to see the importance of the latter. In this paper, I present evidence in support of the latter.

## 1.3. FOR THE SAKE OF CLARITY, I CLASSIFY CORPORATE GOVERNANCE PROVISIONS IN TWO

categories- (I) Internal corporate governance provisions are either part of the firm's charter or are introduced by management from time to time. These corporate governance provisions vary from firm to firm. (II) External corporate governance provisions are the ones that are legislated by the government or some other competent authority, which may vary only at the state or country level. I will focus on the external corporate governance in this paper. The reason for focusing only on the external corporate governance is that the internal corporate governance is under the control of the entrepreneur to begin with, and the management of the firm is generally headed by the entrepreneur later, and it can be adjusted under their preferences. Thus, it is the external corporate governance that is outside the control of the firm and therefore, affects the ex-ante entrepreneurial incentives by affecting the potential rents extracted by the entrepreneur later. Also, since external corporate governance is legislated by the government, it is a policy variable and therefore, studying the effect of external corporate governance can enable us to make useful policy recommendations. In this work, we will argue that strengthening the external corporate governance can hurt the corporate sector by reducing the entry of new startups.

## 1.4. IN THIS WORK, I USE DATA ON BUSINESS COMBINATION (BC) LAWS PASSED BY US

states as a source of exogenous variation in external corporate governance to study the causal effect of corporate governance on entrepreneurship. Note that BC laws make it costlier for raiders to acquire a target firm, and thus passage of BC provisions has been associated with a weakening of external corporate governance. There is already substantial empirical literature documenting the negative effects of these laws on firm performance (Bertrand and Mullainathan (2003); Bebchuk and Cohen (2005); Bebchuk, Cohen and Farrell (2009); Giroud and Mueller (2010)) . Entrepreneurship is measured in this work as the entry of new firms in the economy, as documented in the Business Dynamics Statistics (BDS) dataset.

We find strong evidence of a negative relationship between the strength of corporate governance and entrepreneurship in this paper by using panel regressions. In particular, we find that the passage of a BC law on average leads to an increase in the entry of new firms by more than 2%. The panel regressions in our analysis include: (i) state and year fixed effects to control for state-level time-invariant factors and secular trends in firm creation, respectively; (ii) lagged values for the per capita GDP in the state to control for economic conditions at the state level; and (iii) lagged values of the number of college graduates to proxy for the potential entrepreneurial talent.

There are two major econometric challenges in establishing causality. Firstly, omitted variables such as financial innovations and technological changes may account for BC regulation and increased entrepreneurship. Secondly, the

correlation can be reverse causal, where other factors that led to an increase in firm entry in a state also led to the passage of BC regulation in the state. To address the concerns regarding omitted variable bias, we undertake a placebo test in which we look at the effect on entrepreneurship in a state following the passage of BC laws in a neighbouring state. Ideally, we would expect passage of BC laws in a neighbouring state to not have an impact on the entrepreneurship in that state unless the effect is due to some omitted variable. Finding no significant impact of BC laws in neighbouring states on entrepreneurship should mitigate concerns regarding the omitted variables driving the results in the paper. One other point to note is that it may be the case that the potential entrepreneurs in a state may choose to start a firm in the neighbouring state if that state provides a stronger anti-takeover protection. In this case, however, we should see a negative correlation between the BC index in the neighbouring state and the entry of new firms in the state, but even then, the effect differs from the positive correlation between the two as observed in our basic regressions. To mitigate the concerns regarding reverse causality, we lag our independent variable up to three years and look at the effect of this lagged variable on entrepreneurship.

Our work contributes to the large strand of financial literature that looks at the effect of Corporate Governance on the CEO incentives and firm performance (see Shleifer and Vishny (1997); Bebchuk and Weisbach (2010) for an in-depth survey of the literature). This literature suggests that the weakening of corporate governance regulations leads to an increase in managerial compensation, higher costs, lower equity prices and an increase in unproductive investment. Our work, in contrast to that, suggests that the weakening of the corporate governance regulation may provide better incentives to potential entrepreneurs by increasing the expected rents that they can attract in future in case of success.

Our work is closely related to the literature analysing the effect of BC laws. As mentioned above, this literature documents negative effects of these laws on managerial incentives and firm performance, as opposed to our work. Also, one major difference between this literature and our work is that all these papers look at the effect of these laws on the incentives of management of the existing firms but we, on the contrary, look at the effect on the incentives of potential entrepreneurs that may constitute the management of firms in the future.

This work also has important implications for the corporate governance regulation policy followed by various governments. By providing evidence contrary to the conventional wisdom, this paper suggests that regulators should be mindful of both the negative and positive effects of corporate governance while deciding on optimal regulation policy.

This work is organised as follows. Section 2 reviews the related literature. Section 3 presents the background and our hypotheses. The next section presents our data. Results are presented in Section 5. Section 6 discusses the tests that need to be taken to improve the study. Section 7 concludes.

## 2. LITERATURE REVIEW

There is a large literature documenting the negative effects of weakening in corporate governance provisions. Baumol (1959), Marris (1964) and Williamson (1964) argue that managers are likely to take inefficient projects to extract private rents. Private rent extraction by managers is a bigger problem when these managers are entrenched and prevent hostile takeovers (Bebchuk and Cohen (2005); Jensen and Ruback (1983); Shleifer and Vishny (1989)). Gompers, Ishii and Metrick (2003) construct a governance index using 24 governance rules and show that firms with stronger corporate governance provisions are associated with higher firm value, profits, sales growth and lower capital expenditures.

Borokhovich, Brunarski, and Parrino (1997) show a rise in CEO compensation of firms that are adopting takeover defences. Bertrand and Mullainathan (1999a, 1999b, 2003) document a similar effect for not only CEOs but also other employees after the passage of BC laws that make M&A difficult. They also show that both overall productivity and profitability decline after the passage of these laws. Garvey and Hanka (1999) find that passage of BC laws led to changes in leverage in ways consistent with greater corporate slack.

There is also some work documenting the positive effects of weaker corporate governance provisions. Shleifer and Summers (1989) argue that hostile takeovers can take place even when they are not socially desirable but only privately beneficial for managers, suggesting that corporate governance provisions facilitating takeovers may not necessarily be desirable. Stein (1988) presents a model that suggests that takeover threats can make managers myopic, leading them to sacrifice long-run gains for the sake of short-run profits, thus hurting the firm. Blair (1995) also reaches similar conclusions regarding the negative effects of takeover threats.

Note that all of the above papers look at the effect of corporate governance on executive incentives and firm performance only for the existing firms. However, as we argued above, corporate governance laws can also influence potential entrepreneurs by affecting the rents that they may be able to extract in future if their venture succeeds. Given the importance of new firm creation in the economy, it is not difficult to see the importance of such work. However, the literature on corporate governance laws has been silent in this respect so far. This paper tries to fill this gap in the corporate governance literature by focusing precisely on this statement.

## 3. BACKGROUND AND HYPOTHESES

Bertrand and Mullainathan (1999a, 1999b, 2003) show a rise in CEO pay following the passage of BC laws in a state that shields the management from hostile takeovers by other firms. Similarly, previous literature shows a similar effect on CEO salaries after the firms adopt takeover defences that have similar consequences in shielding the firm from takeovers by raiders (Borokhovich, Brunarski, and Parrino (1997)). Also, Mikkelson and Partch (1997) divided the time into active turnover period (1984-88) and less active takeover period (1998-93) and find that 39% of firms experience CEO turnover in the active turnover period but only 34% firm had such experience in the less active takeover period. Kaplan and Minton (2012) find that the increases in CEO turnover are related to board independence, block shareholder ownership, and Sarbanes-Oxley, all of which strengthen the shareholder rights vis-à-vis management. It is clear from the above discussion that the weakening of corporate governance regulation, such as anti-takeover laws, tend to increase the CEO pay and also decrease the chances of CEO turnover. This implies that anti-takeover provisions help CEO's to not only extract greater rents as CEO but also retain their position for a longer time. Potential entrepreneurs who are likely to be CEOs of their firms, if they succeed, should rationally take into account these increases in future benefits while deciding whether or not to start a firm. This leads us to the following hypothesis:

**Hypothesis 1:** The reduction in CEO turnover along with an increase in

CEO pay following the passage of anti-takeover legislation should increase the entry of new firms.

Some papers in the literature look at the effect of competition on the severity of the agency problem in the product market. Hart (1983), Sharfstein (1988) and Schmidt (1997) show that an increase in the product market competition mitigates the agency problem and forces the managers to increase efficiency by increasing their effort. These papers, however, do not look at the effect of increased competition on executive compensation. Similarly, Giroud and Mueller (2010) look at the effect of the passage of anti-takeover laws and find that the negative effects of these laws, such as increase in input costs, overhead costs and wages, are restricted only to non-competitive industries and there are no such adverse effects in competitive industries. This evidence suggests the potential role played by competition in mitigating the agency problems in the firms. In a similar vein, we expect that the competitive pressure would make it difficult for managers to extract rents in terms of wages or investing in other activities that may improve their share of rents at the cost of firm value, such as investing in an old technology that is more compatible with their professional experience. Thus, anti-takeover legislation is likely to have little effect on entrepreneurial incentives in competitive industries, which leads us to the following hypothesis:

**Hypothesis 2:** Passage of anti-takeover laws should increase entry of new firms disproportionately less in industries with a higher degree of product market competition.

BC laws shield executives from hostile takeover and help them extract higher rents in the form of salaries and other benefits emanating from control. However, it is important to note that these rents accrue only as long as the firm survives. Thus, given the fact that after the passage of BC laws, managerial position is more valuable as it leads to higher rents, the management has higher incentives to take less risk, even if it is at the cost of reducing the expected value of the firms. Reduced risk-taking leads to the following implications for the survival of firms:

**Hypothesis 3:** A decrease in risk-taking leads to a lesser number of firm failures. Also, firms born after the BC law passage tend to survive longer.

Reduction in the failures of new and existing firms, as hypothesised above, leads to a reduction in job destruction. Furthermore, entry of a greater number of new firms should lead to an increase in job creation in the economy. These two should together lead to an increase in employment in the economy and put upward pressure on wages. Thus, we have the following hypotheses:

**Hypothesis 4:** BC laws lead to an increase in employment and wages in the states passing these laws.

## 4. DATA AND PROXIES

For the purpose of this study, we need data on entrepreneurial activity, the timing of passage of BC laws and other state-level characteristics. This section presents the data along with information on data sources. Table 2 below presents the summary statistics.

### 4.1. ENTREPRENEURIAL ACTIVITY

We use a panel data set of establishments across the US states between 1977 to 1995 provided by Business Dynamics Statistics (BDS). The data on firms is available for all the 50 states and districts of Columbia and is arranged according to state, year, firm age and firm size. Therefore, we have a total of 969 observations. The number of startups is calculated as the sum of all firms with a firm age of 0.

The Business Dynamics Statistics (BDS) is a product of the U.S. Census Bureau and was developed by the Centre for Economic Studies (CES). The BDS data are compiled from the Longitudinal Business Database (LBD), which is a longitudinal database of business establishments and firms covering the years between 1976 and 2005. The BDS covers most of the country's economic activity, the only major exceptions being self-employed individuals, employees of private households, railroad employees, agricultural production employees, and most government employees.

Firms are defined at the enterprise level so that all establishments under the operational control of the enterprise are considered part of the firm. In BDS, firm size is defined as the average of year t-1 and year t employment and firm age is defined as the age of the oldest establishment that belonged to the firm at the time of its birth. This definition of the firm age ensures that the firm age does not change abruptly after mergers and acquisitions or divestitures. Firm age is divided into the following twelve categories: a) 0 b) 1 c) 2 d) 3 e) 4 f) 5g) 6 to 10 h) 11 to 15 i) 16 to 20 j) 21 to 25 k) 26+ l) Left Censored. The focus of our analysis in this work, for the most part, is firms of age 0 i.e. startups. Similarly, firm size is also divided into twelve categories based on the number of employees working for a firm. However, we divide the firm into two categories i.e. large firms, which are firms that employ 500 or more employees and small firms that have fewer than 500 employees working for them. Since this BDS data is constructed from the LBD series, which starts in 1976, the firm age variable is, by construction, left-censored at 1975 in our analysis.

### 4.2. CORPORATE GOVERNANCE

We use the passage of anti-takeover laws passed by states as a proxy for corporate governance. These laws are compiled in Bebchuk and Cohen (2003) proxy for takeover

pressure. Bebchuk and Cohen construct an index that takes values from 0 to 5 based on the number of anti-takeover statutes passed by a state (see Bebchuk and Cohen (2003) for details). Note that a higher value of the index is associated with a weakening of external corporate governance as defined in this work.

Table 1 documents the year of law passage by state, the value of the index before the law passage and the value after the law passage. It is clear from the table that this index changes considerably across states and time, which is important for our identification strategy. Note that consistent with the literature, we end our sample in 1995 as the last BC law was passed in 1992 (see Bertrand and Mullainathan, 2003; Giroud and Mueller, 2008 and Sapra et. al. 2013)

### 4.3. STATE LEVEL CONTROLS

We control for the time-varying differences in state economies by including the growth rate of per capita Gross State Product using data from the U.S. Department of Commerce. The other controls that we have used are the number of school graduates and college institutions. These variables control for the educational factors that might affect the entry of firms by affecting the population of people who are educated and can potentially be better entrepreneurs and the quality of the potential workforce.

# 5. RESULTS

**This section presents our results.**

## 5.1. EFFECT OF BUSINESS COMBINATION LAWS ON THE NUMBER OF STARTUPS

We investigate the effect of anti-takeover legislation in a state on the number of new firms entering the state. Since the number of new firms may be expected to be collinear with other state-level unobserved economic, legal and political factors, we exploit state-level exogenous differences in the timing of anti-takeover legislation to identify the causal effect of corporate governance regulation on entrepreneurship. Specifically, since these BC laws were enacted gradually and states enacted these laws at different times, we can use states that did not pass these laws to control for potentially confounding effects in our analysis and thereby, estimate a difference-in-difference regression: the difference in the level of entrepreneurship in a state before and after the passage of BC laws compared to the same difference for states that did not pass such a law in the same period.

To understand this methodology, consider two states that passed these laws at different points in time: Maryland in 1983 and Florida in 1987. Since Florida had not passed a BC law till 1987, the before-and-after difference in entrepreneurship in Maryland due to the passage of regulation in 1983 compared with the before-and-after difference during the same interval for Florida provides a causal estimate of the effect of the anti-takeover legislation in Maryland on entrepreneurship in the state. The reason is that the before-after difference in entrepreneurship in Florida provides an estimate for the following counterfactual question: what would have been the change in entrepreneurship in Maryland if it had not passed an anti-takeover law in 1983?

We estimate the effect of anti-takeover legislation on the number of new firms using the following panel regression:

$$\text{Ln}\,(Y_{st}) = \beta_S + \beta_t + \beta_1 \text{index}_{st-i} + \beta X_{st-1} + \ _{st}, i = 0, 1, 2, 3. \qquad (1)$$

where Yst denotes, number of startups in state s at time t. Indexst—i vari- able captures the number of anti-takeover laws passed by a state s till year t-i, where indexst—i represents the ith lag of the independent variable. The reason for using lagged values of the anti-takeover index is to mitigate concerns of reverse causality, i.e. mitigate the concerns that an increase in entrepreneurial activity in a state somehow motivates legislators to pass this law, leading to the positive correlation between the two. The anti-takeover index can take values from 0 to 5 in our analysis, with zero indicating that a state did not pass a single anti-takeover law. βs and βt denote the state and year fixed effects in the above regression. They control respectively for state-specific, time-invariant and year-specific, state-invariant unobserved factors that may affect our analysis. The coefficient, β1 captures the difference-in-difference estimate of the impact of BC laws on entrepreneurship:

$$\beta_1 = \ln\left(\frac{\overline{Y}_{after}}{\overline{Y}_{before}}\right)\Big|_{\text{state that passed BC law}} - \ln\left(\frac{\overline{Y}_{after}}{\overline{Y}_{before}}\right)\Big|_{\text{state that did not pass BC law}} \qquad (2)$$

In all the regressions, we cluster standard errors by state to account for any autocorrelation in the errors. Table III presents the result of the test of our basic regression equation (1). The results in the first four columns look at the effect of anti-takeover index on entry of new firms after 0,1,2, and 3 years of the passage of anti-takeover laws. These results indicate that anti-takeover laws led to a significant increase in the entry of new firms, consistent with our hypothesis. The coefficient on the BC index is positive and statistically significant in all the specifications of Table III. The next four specifications also control for the per capita income in the state, the number of higher educational institutions in the state and the number of graduates in the state. Our results are robust to the inclusion of these controls, and also, as expected number of startups is positively correlated with these controls, as both a higher per capita income and a greater number of educated people should have a positive impact on entrepreneurship.

Table IV presents the results regarding the effect of the BC law index on the size of the entering firms. As discussed in the data section, we divide size into two categories by the number of people employed by the startup. The firms with less than 500 employees have been assigned a size dummy of 0, and the firms that have more than 500 employees are assigned a size dummy of 1. Similar to the basic regression, we again estimate the effect of the BC law index on the size

of startups after 0, 1, 2 and 3 years after the passage of these laws. It is clear from Table IV that the passage of these laws did not have any significant effect on the average size of the entering firms. This mitigates the concern that even though the number of firms entering the market may be increasing but the positive impact of increased entry might be counterbalanced by a decrease in average size. Note that ideally, we would like to look at the effect of our index on the actual size of the entering firm and not the size divided by categories. Unfortunately, the BDS dataset does not allow us to do this, and therefore, ideally, we would like to work with census data directly to be able to estimate the effect on the actual firm size in the future. I should emphasise that I tried these specifications by dividing firms into different size categories, but in all cases, the effect on size was insignificant at any reasonable level.

## 5.2. ECONOMIC MAGNITUDES

We assess the economic magnitude of the effect of BC laws on entrepreneurship based on our results reported in Table III. The results in column 5 of Table III represent our preferred specification, as it shows the results for entrepreneurship in the same year after including our controls. A coefficient of 0.019 suggests that passage of one additional BC law that led to a unit increase in the BC index increased the entry of new firms by approximately 2% as compared to the baseline average. Other specifications also suggest a similar magnitude of increase in entrepreneurship. The magnitude of the increase is economically significant.

## 6. WORK FOR FUTURE

I plan to conduct the following test to improve the analysis in future:

1) Despite the difference-in-difference estimation, there is some concern that omitted variables may be accounting for our results. For instance, changes in productivity or an increase in the availability of financial capital can also possibly account for our results. To address concerns regarding omitted variable bias, we need to do a placebo test analysing the effect of the passage of these laws on entrepreneurship in neighbouring states. Ideally, these law changes should affect entrepreneurship only in the states that pass them and not the neighbouring states and any effect on neighbouring states, therefore, will raise doubt regarding omitted variable bias.
2) Our hypothesis 2 suggests that passage of anti-takeover laws should increase entry of new firms disproportionately less in industries with a higher degree of product market competition. We need to construct a measure of competition by industry to conduct this test; however, the BDS dataset used for empirical tests in the paper does not allow the construction of such a measure. In future, I plan to use a better source, such as the Census of firms or Compustat, to test this hypothesis.
3) Similarly, the BDS dataset does not allow us to track the survival of individual firms in the database and thus is inappropriate for testing the hypothesis regarding the survival of firms that come into existence after the passage of BC laws. This hypothesis can also be tested with a much richer dataset in the future.
4) A similar conclusion stands true for hypothesis 4 about the increase in employment following the passage of BC laws.

## 7. CONCLUSION

The preliminary results presented in this paper suggest that the weakening of Corporate Governance regulation following the passage of BS laws led to an increase in the number of startups in states passing such laws. However, as suggested in the last section, a lot needs to be done before we can assure ourselves of a causal connection between BC laws and entrepreneurship.

## CONFLICT OF INTERESTS

None.

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**Table 1: BC Index for US States**

This table shows the years of passage of BC laws in US states, along with the value of the index before and after the law passage. This list is compiled by combining the BC law index from Bebchuk and Cohen (2003) with the information of law passage by Bertrand and Mullainathan (2003).

| State | Year | Index Before | Index After | State | Year | Index Before | Index After |
|---|---|---|---|---|---|---|---|
| Colorado | 1989 | 0 | 1 | North Carolina | 1987 | 0 | 2 |
| Connecticut | 1984 | 0 | 1 | North Carolina | 1990 | 2 | 3 |
| Connecticut | 1989 | 1 | 2 | Nebraska | 1988 | 0 | 2 |
| Delaware | 1988 | 0 | 1 | New Jersey | 1986 | 0 | 2 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Florida | 1987 | 0 | 2 | New Jersey | 1989 | 2 | 4 |
| Florida | 1989 | 2 | 4 | Nevada | 1987 | 0 | 1 |
| Georgia | 1985 | 0 | 1 | Nevada | 1989 | 1 | 2 |
| Georgia | 1988 | 1 | 2 | Nevada | 1991 | 2 | 5 |
| Georgia | 1989 | 2 | 4 | New York | 1985 | 0 | 3 |
| Iowa | 1989 | 0 | 2 | New York | 1989 | 3 | 4 |
| Illinois | 1984 | 0 | 2 | Ohio | 1982 | 0 | 3 |
| Illinois | 1989 | 2 | 4 | Ohio | 1990 | 3 | 5 |
| Indiana | 1986 | 0 | 4 | Oklahoma | 1987 | 0 | 1 |
| Indiana | 1989 | 4 | 5 | Oregon | 1987 | 0 | 1 |
| Kansas | 1988 | 0 | 1 | Oregon | 1989 | 1 | 3 |
| Massachusetts | 1987 | 0 | 1 | Oregon | 1991 | 3 | 4 |
| Massachusetts | 1989 | 1 | 4 | Pennsylvania | 1988 | 0 | 1 |
| Maryland | 1983 | 0 | 1 | Pennsylvania | 1989 | 1 | 4 |
| Maryland | 1988 | 1 | 2 | Pennsylvania | 1993 | 4 | 5 |
| Maryland | 1989 | 2 | 3 | Rhode Island | 1990 | 0 | 4 |
| Michigan | 1984 | 0 | 1 | South Carolina | 1988 | 0 | 3 |
| Michigan | 1988 | 1 | 2 | Tennessee | 1988 | 0 | 4 |
| Michigan | 1989 | 2 | 3 | Tennessee | 1989 | 4 | 5 |
| Minnesota | 1984 | 0 | 1 | Utah | 1987 | 0 | 1 |
| Minnesota | 1987 | 1 | 3 | Utah | 1989 | 1 | 2 |
| Minnesota | 1991 | 3 | 4 | Virginia | 1985 | 0 | 1 |
| Missouri | 1984 | 0 | 1 | Virginia | 1988 | 1 | 3 |
| Missouri | 1986 | 1 | 4 | Virginia | 1992 | 3 | 4 |
| Mississippi | 1985 | 0 | 1 | Washington | 1987 | 0 | 2 |
| Mississippi | 1990 | 1 | 2 | Wisconsin | 1984 | 0 | 2 |
| Mississippi | 1991 | 2 | 3 | Wisconsin | 1987 | 2 | 5 |

**Table 2: Summary Statistics**

| Variable | Mean | s.d. | Min | Max | Obs. |
|---|---|---|---|---|---|
| Startups | 9616.18 | 11108.99 | 950 | 72183 | 969 |
| BC Index | 0.886 | 1.523 | 0 | 5 | 969 |
| Per Capita Income | 14886.4 | 5232.181 | 5232 | 31266 | 969 |

**Table 3: Impact of BC Laws on New Firm Entry**

This table shows the effect of BC laws on entry of new firms. The dependent variable in each regression is the logarithm of the number of entering firms from the Business Dynamics Statistics database.

| | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) |
|---|---|---|---|---|---|---|---|---|
| VARIABLES | log firms | log firms | log firms | log firms | log firms | log firms | log firms | |
| Index | 0.024*** (0.008) | | | | 0.019** (0.008) | | | |
| Index(-1) | | 0.021*** | | | | 0.015* | | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Index(-2) | | (0.008) | 0.021*** | | | (0.008) | 0.017** | |
| Index(-3) | | | (0.007) | 0.021*** | | | (0.008) | 0.019** |
| Per capita | | | | (0.007) | 1.362*** | 0.045 | 1.464*** | (0.009) 1.473*** |
| income (-1) | | | | | (0.168) | (0.038) | (0.174) | (0.187) |
| College institutions(- 1) | | | | | 0.099*** (0.036) | -0.020 (0.075) | 0.045 (0.071) | 0.058 (0.069) |
| School graduates (-1) | | | | | 0.567*** (0.112) | 0.233** (0.109) | 0.560*** (0.120) | 0.596*** (0.122) |
| Observations | 969 | 918 | 867 | 816 | 969 | 918 | 867 | 816 |
| Adj R-squared | 0.988 | 0.988 | 0.988 | 0.988 | 0.992 | 0.984 | 0.992 | 0.992 |
| Robust standard errors in parentheses<br>*** p<0.01, ** p<0.05, * p<0.1 | | | | | | | | |

**Table 4: BC Laws and Startup Size**

This table shows the effect of BC laws on the average size of the startups. The data on startup size is taken from Business Dynamics Statistics.

| | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) |
|---|---|---|---|---|---|---|---|---|
| VARIABLES | a1 | a3 | a5 | a7 | a2 | a4 | a6 | a8 |
| | log_size | log_size | log_size | log_size | log_size | log_size | log_size | log_size |
| Index | | | | | | | | |
| | 0.000 | | | | 0.000 | | | |
| Index(-1) | (0.002) | | | | (0.002) | | | |
| | | 0.001 | | | | -0.001 | | |
| Index(-2) | | (0.002) | | | | (0.002) | | |
| | | | 0.001 | | | | 0.001 | |
| Index(-3) | | | (0.002) | | | | (0.002) | |
| | | | | 0.002 | | | | 0.001 |
| Per capita | | | | (0.002) | | | | (0.002) |
| income (-1) | | | | | | | | |
| | | | | | 0.117*** | 0.042*** | 0.155*** | 0.214*** |
| College | | | | | (0.040) | (0.013) | (0.048) | (0.055) |
| institutions(-1) | | | | | | | | |
| | | | | | 0.016 | 0.028 | 0.009 | 0.013 |
| School | | | | | (0.013) | (0.018) | (0.018) | (0.022) |
| graduates (-1) | | | | | | | | |
| | | | | | 0.064* | 0.055 | 0.078* | 0.096** |
| | | | | | (0.034) | (0.035) | (0.040) | (0.044) |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Observations | | | | | | | | |
| Adj R-squared | 969 | 918 | 867 | 816 | 969 | 918 | 867 | 816 |
| | 0.617 | 0.568 | 0.573 | 0.566 | 0.621 | 0.412 | 0.579 | 0.577 |
| | 0.588 | 0.534 | 0.537 | 0.528 | 0.591 | 0.376 | 0.542 | 0.538 |
| Robust standard errors in parentheses<br>*** p<0.01, ** p<0.05, * p< | | | | | | | | |