Stakeholder Orientation and Insider Trading

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Abstract: Using the staggered adoption of constituency statutes across U.S. states as an exogenous shock to stakeholder orientation, we examine its impact on opportunistic insider trading. We show a strong mitigating effect of stakeholder orientation on insider trading. We find that firms incorporated in states that passed stakeholder constituency statutes have a lower likelihood of opportunistic insider purchases, particularly in environments characterized by high information asymmetry and weak monitoring. Additionally, we find that stakeholder orientation mitigates other measures of financial misconduct, like securities class action lawsuits and financial misstatements. Our results are supported by a variety of robustness and causality tests.

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Keywords: insider trading, financial misconduct, stakeholder orientation, constituency statutes

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1. Introduction

Opportunistic insider trading reflects a misalignment of interests between managers and both shareholders and stakeholders. Managers prioritizing personal gain can harm the company's long-term value and reputation, as well as employees, customers, suppliers, and the community[4]. For instance, if insider selling signals forthcoming negative news, stakeholders may suffer losses before they can react[5]. If insiders purchase shares based on non-public favorable information, they can create an information asymmetry that disadvantages other shareholders and stakeholders.

Despite regulations and governance mechanisms aimed at protecting shareholders, opportunistic insider trading persists. There are several reasons for this: Many shareholder-oriented mechanisms emphasize short-term performance metrics and stock price movements. This can inadvertently incentivize managers to engage in opportunistic trading to capitalize on short-term information advantages. For example, stock-based compensation, meant to align manager and shareholder interests, can motivate executives to time their trades based on non-public information about upcoming earnings or corporate events. Existing regulations, such as SEC Rule 10b5-1 trading plans, designed to allow insiders to trade based on pre-set schedules, can sometimes be manipulated. Executives can strategically time the adoption, modification, or cancellation of 10b5-1 plans to their advantage[6]. Shareholder-centric governance often neglects the interests of

[4] For example, in 2001, Enron executives sold large amounts of stock based on non-public information before the company's collapse. Employees and shareholders were left with worthless stock and lost retirement savings, while the community suffered from job losses and economic decline.

[5] In 2001, CEO Samuel Waksal of ImClone systems attempted to sell his shares upon learning that the FDA would reject the company's drug application. Shareholders faced significant losses when the news became public, and the scandal damaged the company's reputation, affecting employees and patients awaiting the drug (https://www.sec.gov/news/press/2002-87.htm).

[6] In 2017, Equifax discovered a massive data breach affecting 147 million consumers. Just days after the July 29th discovery, but over a month before the public announcement, three top executives sold shares worth a combined $1.8 million. CFO John Gamble adopted a new 10b5-1 plan on August 1st, the same day he sold $946,374 in shares. After the September 7th public announcement, Equifax's stock plummeted, losing over a third of its value in weeks. While Equifax said an independent committee investigated and cleared the executives from any wrong-doing, this case raised

other stakeholders who might serve as additional monitors of managerial behavior. This narrow focus can create blind spots in oversight and control mechanisms. For example, a company might have strong shareholder rights but weak employee whistleblower protections, limiting internal checks on executive behavior[7]. Shareholders, especially dispersed ones, may lack the ability or incentive to monitor managerial actions closely. Boards may lack the independence or expertise to effectively oversee and prevent insider trading. Shareholder-centric governance models may not place sufficient emphasis on ethical considerations and corporate culture. If the corporate culture is permissive of aggressive tactics to achieve financial goals, opportunistic insider trading may be more likely. On the other hand, relying on the fear of legal penalties may not be enough to deter insider trading. Managers may calculate that the potential gains outweigh the risks of being caught and penalized. Legal actions can take years, reducing the immediacy of the deterrent effect.

In sum, there are good reasons to argue that current shareholder-oriented corporate governance mechanisms may be insufficient to deter insider trading. Incorporating stakeholder orientation might offer additional deterrents by holding managers accountable to a wider group,

serious questions about executives' use of 10b5-1 plans and insider knowledge. SEC amended Rule 10b5-1 in December 2022 and introduced mandatory cooling-off periods and other restrictions (https://www.sec.gov/newsroom/press-releases/2022-222).

[7] A good example is the case of Wells Fargo and its fake accounts scandal, which came to light in 2016. Between 2011 and 2015, employees opened millions of unauthorized accounts for customers without their knowledge or consent. Despite the scale of the problem, it went unreported for years. Many employees who tried to report the unethical practices faced retaliation, including termination. The scandal was eventually exposed by the Los Angeles Times in 2013, but it took until 2016 for significant action to be taken (https://www.latimes.com/business/la-fi-wells-fargo-sale-pressure-20131222-story.html). Wells Fargo was fined $185 million by regulators. Over 5,300 employees were fired for engaging in these practices (https://www.wsj.com/articles/wells-fargo-to-pay-185-million-fine-over-account-openings-1473352548). The CEO, John Stumpf, eventually resigned and forfeited $41 million in compensation. The focus on shareholder value led to a neglect of other stakeholders, particularly employees and customers. Executives were aware of the aggressive sales tactics and the pressure on employees, information not fully disclosed to the market. This created potential opportunities for informed trading based on non-public information about the company's true practices and risks. The emphasis on meeting short-term sales targets and maintaining high stock prices potentially incentivized executives to overlook or downplay unethical practices. By neglecting employee concerns and whistleblower reports, the company lost a valuable source of internal monitoring that could have exposed the problems earlier.

thus enhancing ethical standards and reducing opportunistic behaviors. While there is extensive research on corporate governance mechanisms deterring insider trading, studies focusing on the role of stakeholders are sparse. This paper aims to fill this gap.

There is a growing body of evidence that stakeholder orientation, which introduces a broader set of constituencies in the corporate board's decision-making, plays a vital role in shaping corporate outcomes[8]. Despite the significant potential harm opportunistic managerial insider trading may cause shareholders and stakeholders, to the best of our knowledge, there have been no studies directly investigating whether stakeholder orientation can mitigate opportunistic insider trading. The closest study we can find is Dai, Parwada, and Zhang (2015), which finds that insider trading profitability is significantly lower for firms with higher media coverage, and the effect is stronger when the media provides new information to the market, showing how one particular stakeholder (media) can play a role in deterring opportunistic insider trading.

In this paper, we address this gap in the literature by examining the impact of variation in the state-level stakeholder constituency statutes on opportunistic insider trading as a type of financial misconduct. We use staggered adoption of the constituency statutes in different U.S. states as an exogenous shock to stakeholder orientation and investigate the associated changes in managers' opportunistic insider trading activity. Financial misconduct like financial misrepresentation (Karpoff, Lee, and Martin (2008)) or opportunistic insider trading (Alexander

[8] Numerous papers find the adoption of constituency statutes has a significant effect on corporate outcomes like cash holdings (Chowdhury, Doukas, and Park (2021)), labor investment efficiency (Chowdhury, Doukas, and Park (2023)), innovation (Flammer and Kacperczyk (2016)), risk taking (Leung, Song, and Chen (2019)), stock price crash risk (Li and Zhang (2020)), discretionary accruals and earnings management (Ni (2020)), share repurchases (Ni, Song, and Yao (2020)), loan spreads (Gao, Li, and Ma (2021)) and operating cost stickiness (Li and Lu (2022)).

and Cumming (2020)) can be extremely costly, and any mechanisms that could reduce its incidence merit further examination. We use the method developed by Ali and Hirshleifer (2017) to measure opportunistic insider trading. We also employ other measures of financial misconduct like firm financial misstatements (Dechow et al. (2011)) and securities class action lawsuits in additional tests.

We find a significant decrease in managerial opportunistic purchases and other financial misconduct in firms incorporated in the states that adopted stakeholder-oriented constituency statutes.

Theoretically, the association between stakeholder orientation and opportunistic insider trading as a type of financial misconduct is somewhat ambiguous. There is some evidence that stakeholder orientation increases board oversight over managerial behavior (Flammer and Kacperczyk (2016)) which could make it harder to engage in opportunistic misconduct. A stronger stakeholder presence on the board after the adoption of constituency statutes by the state can help stakeholders better perform a monitoring role over the managers (Chowdhury, Doukas, and Park (2021)). This heightened monitoring effect can mitigate managers' opportunistic behavior, specifically financial misbehavior.

On the other hand, stakeholder orientation induces long-termism in the board and managerial decision-making (Chowdhury, Doukas, and Park (2023), Flammer and Kacperczyk (2016)), which makes monitoring the short-term managerial activity less effective. Furthermore, stakeholder orientation may induce misaligned incentives among diverse stakeholders, leading to a decreased efficiency of the board monitoring function and, hence, less oversight of short-term managerial behavior (Fich and Shivdasani (2006), Liu et al. (2020)). Moreover, stakeholder orientation may provide self-interested managers with incentives to collude with stakeholders to

act opportunistically and extract private benefits (Bertrand and Mullainathan (2003), Pagano and Volpin (2005), Friedman (2007), Cronqvist et al. (2009), Masulis and Reza (2015)).

Our main measure of insider trading is opportunistic insider trading from Ali and Hirshleifer (2017), who link it with various kinds of firm and managerial misconduct such as financial restatements, U.S. Securities and Exchange Commission (SEC) enforcement actions, shareholder litigation, and executive compensation. Our empirical findings show that the adoption of stakeholder-oriented constituency statutes helps to mitigate opportunistic insider purchases. Our main variable of interest in our tests is *Constituency Statutes,* which takes the value of one if the incorporation state of a firm adopted constituency statutes and the value of zero otherwise. For example, a unit increase in *Constituency Statutes* leads to around a 15% to 25% decrease in the probability of opportunistic purchases. We do not find any effects on insider sales.

We also have a series of robustness checks and additional tests highlighting the mitigating effect of shareholder orientation, following the adoption of constituency statutes, on opportunistic insider purchases and other forms of financial misbehavior. Prior literature demonstrates a higher level of unethical behavior and financial misconduct in cases with a pervasive culture of corruption or local corruption, insufficient or no analyst coverage, ineffective monitoring by shareholders and the board, and higher information asymmetry between corporate insiders and outside investors. This suggests a strong effect of constituency statutes in reducing opportunistic insider trading in areas with more corruption, in firms with no analyst coverage, a low percentage of institutional ownership, with co-opted boards, and a higher probability of informed trading. For example, a unit increase in *Constituency Statutes* is associated with a 30% decrease in the probability of opportunistic purchases in firms headquartered in states with more corruption, whereas the effect on purchases is insignificant for firms headquartered in states with less corruption. Similarly, a

unit increase in *Constituency Statutes* leads to a 32% decrease in the probability of opportunistic purchases in firms with no analyst coverage, whereas no significant effect is observed for firms with analyst coverage. When boards are ineffective monitors, constituency statutes have a strong mitigating effect on opportunistic purchases, reducing the probability by 53% in firms with co-opted boards. Once again, no significant effect is found on purchases in firms that do not have co-opted boards. When the probability of informed trading is high, constituency statutes reduce the probability of opportunistic purchases by 37%, whereas no effect is observed for firms with a low probability of informed trading. These findings provide additional evidence supporting the mitigating effect of stakeholder-oriented policies on financial misconduct.

We also find a pronounced impact of *Constituency Statutes* on other forms of financial misconduct. For example, the adoption of constituency statutes is associated with a reduction of the likelihood of securities fraud. A unit increase in *Constituency Statutes* leads to a 29% decrease in the probability of securities class action lawsuits. Similarly, we examine the effect of constituency statutes on financial misstatements by using the Dechow et al. (2011) data on the Accounting and Auditing Enforcement Releases (AAERs) with alleged financial misstatements and show that a unit increase in *Constituency Statutes* is associated with 25% decrease in the probability of financial misstatement. These findings present additional evidence highlighting the effect of constituency statutes in reducing financial misconduct.

Our paper contributes to the burgeoning literature on stakeholder orientation and corporate outcomes in several ways. First, our results demonstrate the mitigating effect of the stakeholder orientation on opportunistic insider purchases, which might be of interest to corporate governance and legal professionals. Second, in our paper, we document an attenuating effect of stakeholder orientation on factors like high local corruption, low institutional ownership, low analyst coverage,

co-opted boards, and a high probability of informed trading that have been associated with higher levels of financial misconduct. Third, we show that stakeholder orientation mitigates other measures of financial misconduct as well, broadening the application of our results. We expect our findings to be a relevant argument in the development of a legal framework aimed at better corporate governance and a more responsible role of the firm in society.

The remainder of this paper is organized as follows. The next section provides institutional background and develops our hypotheses. Section 3 describes the data and the measures we use. Section 4 presents our main findings. Section 5 provides a conclusion.

2. Institutional background and hypothesis development

Between 1984 and 2006, more than half of the U.S. states adopted constituency statutes[9]. The adoption of constituency statutes expands directors' fiduciary duties beyond the traditional focus on shareholder value maximization, legally empowering them to consider the interests of a broader stakeholder group, including employees, customers, suppliers, and local communities[10]. This alters the implications of the advising and monitoring roles of the board. Adams and Ferreira (2007) build a theoretical model to examine the dual advising and monitoring role of the boards. They show that CEO-friendly boards, which have little effect on monitoring the CEO and with interests not fully aligned with shareholders, may be optimal due to the effect of board friendliness on the quality of advice it provides to the CEO. Given the evidence that CEOs' preferences are

[9] Appendix Table A.2 provides the list of U.S. states which adopted constituency statutes and the years when they became effective.

[10] The implementation of constituency statutes led to significant variations in corporate governance across different states. For example, Connecticut's statute, enacted in 1988, stands out as one of the strongest, as it requires directors to consider stakeholder interests rather than merely permitting it. Pennsylvania's statute, one of the most comprehensive, has been credited with helping to retain businesses in the state by providing a shield against hostile takeovers that might have led to job losses or community disruption.

aligned with those of employees (Bertrand and Mullainathan (2003)), Adams and Ferreira (2007) argue that "nonshareholder constituency statutes may not be as detrimental to shareholder value as many argue, because they allow boards' preferences to be more aligned with those of managers." On the other hand, Harris and Raviv (2008) find that, in many cases, shareholders prefer an insider-controlled board and that outside board control may be value-reducing. To the extent stakeholder-oriented boards are controlled by outsiders, this suggests nonshareholder constituency statutes can be value-reducing. Our purpose in this paper is to examine whether the adoption of constituency statutes curtails opportunistic managerial behavior and misconduct like opportunistic insider trading, misstatements, and AAERs. While we do not look at value implications directly, it is not a stretch to argue that any mitigation of opportunistic behavior provided by constituency statutes should be value-improving.

We posit and test the following hypotheses:

H1: Adoption of Constituency Statutes will enable more effective monitoring by a more diverse group of stakeholders. This will deter opportunistic managerial behavior, and reduce opportunistic insider trading, as well as other financial misconduct.

A board that also considers nonshareholder stakeholder interests will have diverse connections or mechanisms in place to listen to employees, customers, suppliers, and the local community to quickly discover and act on management's wrongdoing. For example, improved whistle-blowing protections for employees, which Wells Fargo lacked in 2016 but could have helped them avoid the fake accounts scandal, is one such mechanism[11].

H2: The mitigating effect of constituency statutes on reducing opportunistic managerial

[11] Instead, Wells Fargo's shareholder-oriented board did not intervene as the management pressured employees to meet short-term financial goals through unethical conduct.

behavior will be strong for managers in firms with weaker existing shareholder and outsider monitoring, like those with low institutional ownership and no analyst coverage. The mitigating effect will also be strong for managers in firms headquartered in areas with high local corruption. In all of these cases, the incremental and diverse monitoring allowed by constituency statutes will reduce opportunistic behavior where it is likely to happen the most.

H3: Managers in firms where the CEO is friendly with the board will significantly reduce their opportunistic behavior when the firm is incorporated in a constituency statute state. There are two ways this can happen. One might argue that a CEO-friendly board is an ineffective monitor, and therefore, improved monitoring enabled by constituency statutes makes a greater difference for such firms. The second argument would be that the interests of CEO-friendly boards would be more aligned with the CEO and the managers when there is stakeholder orientation. This is because CEOs' and managers' interests are more aligned with employees, an important stakeholder group. According to Adams and Ferreira (2007), in such firms, CEOs and managers will provide higher-quality information to the board, and the board will give better advice to the CEO. Given the greater transparency to the board, managers may have fewer opportunities to engage in opportunistic behavior and may find it more costly.

H4: Firms with more informative prices as measured by high levels of probability of informed trading (PIN), idiosyncratic volatility, or illiquidity will benefit more from the additional monitoring supplied by constituency statutes.

Ferreira, Ferreira, and Raposo (2011) develop a theoretical model to explain how price informativeness affects board monitoring and test it empirically. They find a negative relation between price informativeness and board independence. In their model, price informativeness and

board monitoring are substitutes. They find that firms with informative stock prices (high PINs) have less demanding board structures. High PIN values suggest a higher probability of informed trading, indicating significant information asymmetry between insiders and outside investors and substantial insider influence or control over information flow. This might suggest the board may not be sufficiently independent from management, and there could be weaknesses in the board's ability to oversee and control insider activities. In our case, we expect the additional monitoring provided by stakeholders to be more impactful on firms with informative stock prices, which, according to Ferreira, Ferreira, and Raposo (2011), should have less demanding board structures and monitoring.

H5: The mitigating effect of constituency statutes on managerial opportunism will lead to fewer securities class action lawsuits and misstatements. Literature suggests a link between informed insider trading and posterior class action lawsuits. For instance, Beneish (1999) find evidence of insider employees selling their holdings before the revelation of earnings statements and the subsequent charges brought by the SEC. Furthermore, Iqbal, Shetty, and Wang (2007) find a reduction in insider sales immediately before the class period suggesting that class action lawsuits, on average, have merit. Gao, Li, and Ma (2021) show that constituency statutes limit earnings management, while Ni (2020) suggests that they decrease it. Building upon this research, we expect constituency statutes to have a mitigating effect on financial misstatements.

Before we proceed with our tests, it is important to answer the following question: “Does the adoption of constituency statutes in a firm’s incorporation state really focus the firm to become more stakeholder-oriented?” There are numerous examples of firms acting with greater consideration for stakeholder interests after the adoption of constituency statutes in their incorporation state. Figure 1 shows the ratio of the frequency of the word “stakeholder” to the sum

of the frequencies of the words "shareholder" and "stockholder" in 10-K filings around the adoption of constituency statutes in the firms' states of incorporation. There is a substantial initial spike in the stakeholder ratio during the adoption year (a 346% increase), and the ratio remains elevated post-adoption relative to pre-adoption years. This suggests that firms, in general, recognize the consequences of the adoption of constituency statutes in their states of incorporation and address them in their filings.

It is likely that some firms were already considering stakeholder interests before these laws were passed. However, it would be reasonable to argue that the legal protection provided by constituency statutes would make stakeholder orientation even stronger in firms that already have them and encourage firms that do not have them to adopt such policies in the first place. Ben & Jerry's, incorporated in Vermont, is a good example. Vermont passed a constituency statute in 1998. While Ben & Jerry's was already known for its socially responsible practices, the law provided additional legal protection for its stakeholder-oriented policies. This became particularly relevant during its acquisition by Unilever in 2000, where the board could consider factors beyond just the highest bid price[12].

The Pennsylvania constituency statute, which was passed in 1990, provided a strong anti-takeover tool for companies incorporated in the state. When faced with a hostile takeover bid from Norfolk Southern in 1996, Conrail initially agreed to a friendly merger with CSX. Conrail's board cited the constituency statute to justify accepting the lower CSX offer, arguing it would better serve various stakeholder interests. "Upon announcement of the merger, CSX and Conrail began extolling the benefits of the deal. In its proxy statement, Conrail asserted that the merger with CSX

[12] Eventually Unilever agreed to several unusual terms that preserved Ben & Jerry's stakeholder-oriented practices like committing to the company's social mission, continuing to source milk from Vermont dairy farms, maintaining certain employee benefits and committing a percentage of profits to the Ben & Jerry's Foundation (https://www.nytimes.com/2000/04/13/business/ben-jerry-s-to-unilever-with-attitude.html).

is ‘in Conrail's best interests and is the superior strategic combination.’[13] In a joint press release, Snow of CSX was quoted as saying that the merger was a ‘win-win transaction for the shareholders of both companies, our customers and the communities we both serve.’ ”[14] (Nickerson (1997)). Norfolk Southern CEO David R. Goode criticized CSX CEO John Snow for trying to use Pennsylvania’s constituency statute to derail Norfolk’s bid. Apparently, John Snow told him that “the "Pennsylvania statute," referring to Pennsylvania's Business Corporation Law, was "great" and that Conrail's directors have almost no fiduciary duties.” [15]

Although not a hostile takeover, the Hershey Trust's attempt to sell its controlling interest in Hershey Foods in 2002 was blocked partly due to considerations allowed by the constituency statute. The potential sale was halted due to concerns about the impact on the local community, which the statute allowed directors to consider[16]. In sum, these examples suggest that the likelihood of stakeholder-oriented conduct will indeed increase in the presence of constituency statutes.

3. Data and Sample

Our sample runs from January 1983 through the end of March 2022. We require available stock price data in the Center for Research in Security Prices (CRSP) and accounting data in COMPUSTAT databases. We obtain incorporation state data from Compustat. We define constituency states following Gao, Li, and Ma (2021). We obtain the historical headquarters data

[13] Conrail Inc., 14A Proxy Statement, at 6 (Nov. 25, 1996)
[14] Conrail/CSX Joint Press Release (Oct. 15, 1996) (quoting John W. Snow, chairman).
[15] (Conrail Inc., Schedule 14D1/A, October 24, 1996, https://www.sec.gov/Archives/edgar/data/277948/0000898822-96-000458.txt)
[16] “Pennsylvania Attorney General, in his parens patriae role, sought to block the sale by petitioning a court to order the trustees of the Hershey Trust to show cause as to why the sale of the trust's controlling interest in Hershey Foods should not require court approval. The Pennsylvania Orphans' Court granted an injunction halting the sale, and the Commonwealth Court of Pennsylvania later affirmed this injunction.” (Komoroski (2004))

from Bai, Fairhurst, and Serfling (2020) for the pre-1993 period, who hand-collected it from the Moody's Manuals (later Mergent Manuals) and Dun & Bradstreet's Million Dollar Directory (later bought by Mergent). For the 1993-2022 period, we use the Python and SAS code[17] from Gao, Leung, and Qiu (2021) to extract the business address from the 10-X Header data file from the Notre Dame Software Repository for Accounting and Finance (SRAF)[18] prepared by Loughran and Mcdonald (2016). 10-X Header file includes all of the information in the header section of 10-K/Qs (and all variants) filed on the Securities and Exchange Commission's (SEC) EDGAR database. If the business address is missing or invalid when parsing the headers, we use the Compustat data.

The insider trading data on open market sales and open market purchases is from the Thomson Reuters Insider Filings database[19]. For our analysis, we focus on trades by managers and directors. We define managers as all insiders who are officers, officer-directors, or officer-shareholders[20]. We exclude trades made by blockholders who are not managers or directors. We exclude amended filings and filings with cleanse codes 'A' and 'S'. We exclude transactions where the transaction price is below $2, require the transaction price to be between low and high price for the day, and to be between 80% and 120% of the day's closing price. We require the number of shares in a transaction to be less than the daily trading volume and less than 50% of the shares outstanding from CRSP daily stock file. If the transaction price is missing, we use the daily closing price from

[17] https://mingze-gao.com/posts/firm-historical-headquarter-state-from-10k/
[18] https://sraf.nd.edu/data/augmented-10-x-header-data/
[19] We use both Idfhist and Table1 data files. Idfhist starts meaningful coverage in 1983 and goes until 2000. Table1 data file starts meaningful coverage in 1986 and goes until 2022. We get trading data from Idfhist only for those managers who are also present in the Table1 file. Idfhist and Table1 use different unique insider identification codes. We matched them based on insider names. During the 1986-2000 period when these files overlap, we avoid duplication of data and get transactions from Idfhist only if they do not exist in Table1 data file.
[20] We use the following position codes to identify officers (managers): AV, C, CB, CEO, CFO, CI, CO, COO, CT, EVP, GC, GM, GP, H, O, OB, OD, OE, OT, OX, P, SVP, TR, VC, and VP. We use the position code D to identify directors.

CRSP. We only focus on open market purchases and open market sales (transaction codes "P" and "S") and only use transactions in directly owned shares (ownership code "D"). We consolidate the number and value of shares traded for multiple trades of the same type occurring on the same transaction date by the same insider. To identify opportunistic insider trades, we use the method proposed by Ali and Hirshleifer (2017), classifying a trade as opportunistic if it is conducted by an insider who falls within the top quintile of the profitability ranking of their past trades before quarterly earnings announcements (QEAs). We use both Compustat and IBES databases to obtain the most accurate estimate of quarterly earnings announcement dates (QEADs). When QEADs from two sources differ, we use the earlier date, and when they agree, and the date is before Jan 1, 1990, we shift the day to the previous trading date (see Dellavigna and Pollet (2009)) [21]. Following Johnson and So (2018), we eliminate observations where Compustat and IBES announcement dates are more than two trading days apart, and if the adjusted announcement date is the same as the IBES announcement date, we use the IBES time stamp to see if the announcement occurred after the market close. If it does, we move the announcement date one day forward. For each QEA, we obtain an insider's open market buys and sales during the trading days -21 through -3 relative to the QEA day (day 0)[22]. We then calculate the profitability of each of these pre-QEA trades by determining the average market-adjusted return for the QEA period, spanning days -2 through +2 relative to the QEA day:

$$\text{Profit} = \sum_{j=-2}^{j=2}(r_{(i,t+j)} - r_{m,t+j})/5 \qquad (1)$$

where t is the QEA date, $r_{i,t}$ is stock i's return on day t, and $r_{m,t}$ is the return on the CRSP equal-weighted index on day t.

[21] Dellavigna and Pollet (2009) find that utilizing both databases improves the accuracy of earnings announcement date to 95%, far higher than when using each database in isolation.
[22] To focus on economically significant opportunistic trading during the pre-QEA window, we only use transactions with a value greater than $5,000.

Then, for each insider and for each year, we define the average profitability of the insider's past pre-QEA trades as:

$$\text{Average Profit} = (\sum^{B} Profit_{Buy} - \sum^{S} Profit_{sell})/(B+S) \quad (2)$$

where B (S) is the total number of pre-QEA buy (sell) trades made by the insider prior to the start of the year. If an insider makes multiple trades in a particular pre-QEA period, we aggregate the trades and classify them as a buy (sell) trade if the number of shares bought is greater (less) than the number of shares sold by the insider during the pre-QEA period[23]. At the beginning of each year, we rank insiders into quintiles based on their calculated Average Profit. Insiders falling within the top quintile are labeled as opportunistic, and their trades conducted in the ranking year are classified as opportunistic trades. Conversely, all other trades are considered non-opportunistic.

Table 1 presents the descriptive statistics of our sample. Panels A and B report descriptive statistics for independent and dependent variables used in the main insider purchase and sales regressions. 3.2% of purchase transactions and 5.8% of sales transactions are classified as opportunistic using the QEA date. Purchases are preceded by a negative past six-month return of -0.3%, suggesting that managers tend to buy when they believe their stock is undervalued. On the other hand, sales are preceded by a positive past six-month return of 22.6%, consistent with managers selling after a price run-up for diversification and rebalancing reasons. Sales transactions tend to be bigger in size, and CEOs and CFOs are quite active in trading, accounting for 12.1% and 5.4% of purchases and 12.3% and 7.1% of sales, respectively. Firms in sales transactions tend to be large growth firms with higher analyst covering and a higher fraction and concentration of institutional ownership, consistent with managers in larger and potentially overvalued firms selling more. State-level socioeconomic characteristics (population, income, education, minority ratio,

[23] During the aggregation of trades during the pre-QEA period, we use split adjusted number of shares and prices.

age 65 and older) for purchase and sale transactions are similar. Overall, the results in Table 1 show that a small but significant number of trades are opportunistic trades. Additionally, a significant proportion of all the insider trades are in firms that are incorporated in constituency statutes states: 40.6% of firms in purchase transactions and 24.9% in sales transactions. The rest of the results are mostly in line with the literature (see, for example, Contreras, Korczak, and Korczak (2023)) and our expectations.

[Insert Table 1 Here]

4. Empirical Tests

4.1. Main Tests

Table 2 presents our main results, where we use a logit model to examine the impact of *Constituency Statutes* on opportunistic insider trading. We expect that the stakeholder orientation induced by the adoption of *Constituency Statutes* in the incorporation state of a firm will reduce the likelihood of opportunistic insider trades. The dependent variable is the opportunistic trade dummy, set to one if the trade is made by an insider who is in the top quintile of the profitability ranking of past trades before earnings announcements. Columns 1 through 3 report results for purchases, and columns 4 through 6 for sales.

[Insert Table 2 Here]

It is important at this point to note the asymmetry of motives in sales and purchases and its implications for our results. Sales can occur for various reasons unrelated to the company's prospects, such as portfolio diversification and rebalancing, liquidity needs, tax planning, or personal expenses. They may simply represent a reallocation of wealth without necessarily signaling negative information. That said, opportunistic sales still exist; therefore, sales

transactions are more closely scrutinized by regulators to deter informed trading based on negative information. But overall, the signal for opportunism in sales transactions is noisier. Purchases typically have a single primary motive – the expectation of future price appreciation based on private information. They require managers to invest their own capital, indicating a strong belief in future performance. They are less frequent than sales, making them more noteworthy to the market when they occur, and typically elicit a stronger positive market reaction. They are more likely to be based on positive private information that the market does not yet have. For these reasons, purchases provide a cleaner signal to detect opportunistic trading.

The main variable of interest in Table 2 is *Constituency Statutes*, which takes the value of one if the incorporation state of a firm adopted *Constituency Statutes* and zero otherwise.

We use three different model specifications. The model in columns (1) and (4) is the least restrictive and uses only firm-level controls known to influence insider trading, such as market capitalization and book-to-market ratio (both in log form), past return and volatility (measured over the past six months), change in volatility, log of trade size, and dummy variables indicating whether the insider is the Chief Executive Officer (CEO) or the Chief Financial Officer (CFO). Columns (2) and (5) add variables measuring corporate governance, like fraction and concentration of institutional shareholders, accruals, Amihud (2002) illiquidity measure, and number of analysts covering the firm. Columns (3) and (6) add headquarter-state-level socio-economic and demographic variables like population, income, education, minority percentage, and the percentage of 65 and older population[24]. Since the results are similar, we only use the full specification of columns (3) and (6) in the rest of the tables to save space. All regressions include year and industry-fixed effects.

[24] Results are similar if headquarter-county-level socio-economic and demographic controls are used and are available upon request.

Constituency Statutes has a negative and statistically significant coefficient for all model specifications for purchases, suggesting that the adoption of *Constituency Statutes* makes opportunistic purchases less likely. The effect is also economically significant. A unit increase in *Constituency Statutes* decreases the probability of an opportunistic trade by 15% in column (1), 22% in column (2), and 25% in column (3). On the other hand, we do not find a similar effect on sales. Due to the reasons mentioned earlier, purchases provide a much cleaner signal about opportunistic behavior than sales. Therefore, the significant effect on purchases suggests that constituency statutes indeed help mitigate managers' opportunistic behavior.

In sum, our results in Table 2 suggest that the adoption of *Constituency Statutes* leads to a reduction in the likelihood of opportunistic insider purchases and supports our first hypothesis. This finding indicates that the adoption of *Constituency Statutes* might help eliminate financial misbehavior related to insider trading.

4.2. Effect of Constituency Statutes when opportunism is more likely

In this section, we test our second hypothesis to see whether constituency statutes mitigate opportunism when and where it is more likely to happen. We look at the effect of constituency statutes on opportunistic trading for subsamples divided by local corruption, level of institutional ownership, and the level of analyst coverage.

We first look at firms headquartered in states with high levels of corruption. Recent studies have highlighted the link between corporate and financial outcomes and corruption culture[25]. This

[25] Parsons, Sulaeman, and Titman (2018) analyze the impact of local unethical behavior on financial misconduct. Liu (2016) underlines the association between the corruption culture in the ancestral country of corporate managers and financial misconduct. Ucar and Staer (2020) show the impact of local corruption on corporate social responsibility (CSR).

literature suggests a positive association between unethical behavior, particularly financial misconduct, and the corruption culture and local corruption. Therefore, we expect a strong effect of constituency statutes in reducing opportunistic insider trading when there is more prominent local corruption if stakeholder orientation induced by constituency statutes is indeed effective in mitigating opportunistic behavior. To test this, we divide our sample into high and low local corruption subsamples based on the level of local corruption in the firm's headquarters state[26]. Following the related literature (e.g., Butler, Fauver, and Mortal (2009), Ucar and Staer (2020)), we use local federal corruption convictions per capita as a proxy for local corruption culture[27]. Table 3 presents the results. Columns 1 and 3 (2 and 4) show results for purchases and sales for firms headquartered in low (high) corruption states.

[Insert Table 3 Here]

Constituency Statutes significantly mitigate opportunistic purchases for firms incorporated in high-corruption states (column 2). The coefficient is -0.355, and significant at 1% level. A unit increase in *Constituency Statutes* dummy from 0 to 1 reduces the probability of opportunistic purchases by 30%. This is a sizable effect and is consistent with our earlier conjecture. The effect on purchases in low corruption states is also negative, but half that amount in magnitude and insignificant. While the difference between these two coefficients seems to be insignificant[28] these results nevertheless show that *Constituency Statutes* indeed help mitigate opportunistic behavior where it is more likely to happen, namely in areas with a high local corruption culture.

[26] Results are similar if incorporation state is used. However, we believe measuring such local variables at the headquarter-state level is more relevant, since most top managers are likely residing in the headquarter state.
[27] We thank Alex Butler for making the updated state level corruption conviction data available on his website. (http://butler.rice.edu/corruption/). We winsorize the conviction per capita values at one percent level.
[28] An F-test for the equality of coefficients of *Constituency Statutes* in columns 1 and 2 fails to reject the null with a p-value of 0.231.

Next, we examine subsamples based on the level of institutional ownership. Prior literature indicates that institutional ownership has a monitoring effect on firms[29]. These studies also suggest a stronger monitoring effect of institutional ownership on insider trading, so we expect constituency statutes to have a more pronounced effect in mitigating opportunistic insider trading when there is lower institutional ownership. To test this, divide our sample into high and low institutional ownership. A firm is designated as a low (high) institutional ownership firm if institutional investors hold less (more) than 50% of the shares outstanding. Institutional ownership data comes from Thomson Reuters' S34 database. We then repeat our main tests for low and high institutional ownership subsamples in Table 4. Columns 1 and 3 (2 and 4) show results for purchases and sales for firms with high (low) institutional ownership.

[Insert Table 4 Here]

Once again, constituency statutes have a significant mitigating effect on opportunistic purchases where it is needed the most. The coefficient for *Constituency Statutes* for firms with low institutional ownership (column 2) is -0.400 and significant at a 1% level. A unit increase in *Constituency Statutes* dummy from 0 to 1 reduces the probability of opportunistic purchases by 33%. The coefficient for high institutional ownership firms (column 1) is also negative but insignificant. While the difference is insignificant[30], these results nevertheless show an

[29] Hillegeist and Weng (2021) state that "recent studies using the Russell index setting conclude quasi-indexers are active monitors who have a positive effect on certain governance and corporate practices (e.g., Appel, Gormley, and Keim (2016), Boone and White (2015), Crane, Michenaud, and Weston (2016))". Crane, Michenaud, and Weston (2016) emphasize the monitoring role of institutions on firm behavior. Appel, Gormley, and Keim (2016) point out that passive mutual funds influence firms' corporate governance, leading to more independent directors, removal of takeover defenses, and more equal voting rights. Boone and White (2015) suggest that higher institutional ownership leads to greater management disclosure, analyst following, liquidity, and lower information asymmetry. Hillegeist and Weng (2021) examine insider trading and show that higher quasi-indexer institutional ownership is associated with less insider trading (both buys and sells) and less profitable trades for sells.

[30] An F-test for the equality of coefficients of Constituency Statutes in columns 1 and 2 fails to reject the null with a p-value of 0.148.

economically significant mitigating effect of constituency statutes on opportunistic purchases for firms with weak monitoring by institutional shareholders. As before, we do not find any effect on sales.

Next, we look at subsamples split by analyst coverage. Previous literature suggests that analyst coverage has a monitoring effect on firms and can help reduce financial misconduct[31]. This suggests a higher level of financial misbehavior when there is less or no analyst coverage and a lower level of financial misconduct when there is some monitoring by financial analysts. We expect a strong mitigating effect of *Constituency Statutes* in reducing financial misbehavior in opportunistic insider trades in firms with no analyst coverage if the empirical findings in our main tests are driven by the adoption of *Constituency Statutes*. To investigate this conjecture, we divide our sample into two subsamples: firms with no analyst coverage and firms with analyst coverage, and we re-run our main tests.

[Insert Table 5 Here]

Constituency Statutes significantly mitigate opportunistic purchases for firms with no analyst coverage (column 2). The coefficient is -0.391 and significant at the 1% level. A unit increase in *Constituency Statutes* dummy from 0 to 1 reduces the probability of opportunistic purchases by 32%. Once again, this is an economically meaningful effect and is consistent with our earlier conjecture. The effect on purchases in firms with analyst coverage is also negative but is less than half that amount in magnitude and insignificant. The difference between these two coefficients

[31] Yu (2008) shows a negative relationship between analyst coverage and earnings management. Chen, Harford, and Lin (2015) suggest that " financial analysts play an important governance role in scrutinizing management behavior.", while Yang, Wang, and Xue (2021) find that analyst coverage reduces the likelihood of corporate misconduct. Ellul and Panayides (2018) document a mitigating influence of analyst coverage on the probability and profitability of informed trading.

seem to be insignificant[32]. Consistent with our expectation, *Constituency Statutes* once again helps mitigate opportunistic behavior where it is more likely to happen, this time in firms with no analyst coverage and hence weak outside monitoring. As before, we do not observe any effect on sales.

Taken in sum, these results support our second hypothesis that there is a strong mitigating effect of constituency statutes on opportunistic purchases when and where opportunism is more likely to happen due to high local corruption and weak shareholder and outsider monitoring.

4.3. Effect of Constituency statutes for firms with Co-opted Boards

Next, we test our third hypothesis by examining subsamples split by firms with co-opted boards and those without co-opted boards. The third hypothesis expects a strong mitigating effect of constituency statutes on opportunistic trading in firms with co-opted boards. This can be due to greater alignment of the board and CEO when there is stakeholder orientation, as suggested by Adams and Ferreira (2007). In such firms, managers may find engaging in opportunistic behavior difficult and costly due to higher transparency as a result of greater and higher quality information flow between the management and the board. Alternatively, one might argue that co-opted boards are simply weak monitors, and hence, the incremental monitoring from constituency statutes has a strong mitigating effect on opportunistic behavior. We use the co-option independence ratio measure of Coles, Daniel, and Naveen (2014), which is the ratio of independent directors appointed by the incumbent CEO to the number of board members. Firms with co-opted (not-co-opted) boards have higher (lower) than median co-option independence ratio.

We find a strong mitigating effect of Constituency Statutes on opportunistic purchases for firms with co-opted boards (column 2). The coefficient is -0.746 and significant at the 1% level. A unit

[32] An F-test for the equality of coefficients of *Constituency Statutes* in columns 1 and 2 fails to reject the null with a p-value of 0.213.

increase in Constituency Statutes dummy from 0 to 1 reduces the probability of opportunistic purchases by 53%. This is a sizable and economically meaningful effect and supports our third hypothesis. The effect on purchases in firms without co-opted boards (column 1) is positive and insignificant. The difference between these two coefficients is significant at the 1% level.[33] This provides one more piece of evidence on the effectiveness of constituency statutes in mitigating opportunistic behavior.

4.4. Effect of Constituency statutes for firms with a high probability of informed trading (PIN)

Now, we test our fourth hypothesis by examining subsamples split by firms with a high (low) probability of informed trading (PIN). PIN is a measure of price informativeness proposed by Easley et al. (1996). In line with Ferreira, Ferreira, and Raposo (2011)'s conjecture, we expect firms with informative stock prices (high PINs) to have less demanding board structures and monitoring. As a result, we expect a strong effect of the additional monitoring provided by stakeholders on mitigating opportunistic trading. We use the annual PIN measure calculated using the Venter and de Jongh model (Venter and De Jongh (2006)), which covers the period 1993-2010.[34]

Constituency Statutes significantly mitigate opportunistic purchases for firms with informative prices (column 2). The coefficient is -0.467 and is significant at the 1% level. A unit increase in *Constituency Statutes* dummy from 0 to 1 reduces the probability of opportunistic purchases by 37%. Once again, this is an economically meaningful effect and is consistent with our earlier

[33] An F-test for the equality of coefficients of *Constituency Statutes* in columns 1 and 2 rejects the null with a p-value of 0.008.
[34] We thank Stephen Brown to make the data available at: https://terpconnect.umd.edu/~stephenb/pinsdatanew.html

conjecture. The effect on purchases in firms with not-informative prices (column 1) analyst coverage is also negative but insignificant. The difference between these two coefficients seems to be insignificant[35]. Consistent with our expectation, *Constituency Statutes* once again help mitigate opportunistic behavior where it is more likely to happen, this time in firms with informative stock prices. Such firms tend to have high information asymmetry, insider-dominated information flow, and weak board monitoring. Results are similar if we partition the sample using alternative measures of price informativeness like idiosyncratic volatility or illiquidity[36]. As before, we do not observe any effect on sales.

Taken in sum, these results support our fourth hypothesis that there is a strong mitigating effect of constituency statutes on opportunistic purchases when and where opportunism is more likely to happen, this time in firms with higher information asymmetry characterized by more informative stock prices.

4.5. Effect of Constituency statutes on Class Action Filings and Earnings Misstatements

We now test our fifth hypothesis that the mitigating effect of constituency statutes on managerial opportunism will lead to fewer securities class action lawsuits and misstatements. We first focus on securities class action lawsuits using the securities fraud litigation data from the Securities Class Action Clearinghouse database. Prior literature suggests a link between informed insider trading and posterior class action lawsuits (Beneish (1999), Iqbal, Shetty, and Wang (2007)).

[35] An F-test for the equality of coefficients of *Constituency Statutes* in columns 1 and 2 fails to reject the null with a p-value of 0.540.
[36] Results available upon request.

Our Securities Class Action Clearinghouse (SCAC) dataset includes securities class actions with filing dates, company tickers, and other relevant information. We match this dataset with the firms in our sample and identify the firms with securities class action filings for the years 1996-2021. For each firm-year, we construct a dummy variable, 'Class Action Filing,' which takes the value of one if there is a securities class action lawsuit filed in a year and zero otherwise. Next, we investigate the impact of constituency statutes on securities fraud litigation by running a logit regression with the dependent variable as 'Class Action Filing' and the variable of interest being '*Constituency Statutes*.'

We present results using all three model specifications in columns 1 through 3 of Table 8. The coefficient of *Constituency Statutes* is negative and significant in all of them. For example, in column 1, the coefficient is -0.335, which is significant at the 1% level. This result is economically significant as well. A unit increase in *Constituency Statutes* leads to a 29% decrease in the probability of securities class action lawsuits. This suggests that the adoption of constituency statutes in the incorporation state of a firm reduces the likelihood of securities class action lawsuits, possibly due to the reduced likelihood of securities fraud. Results are similar when we add corporate governance and local socioeconomic and demographic controls in columns 2 and 3. Overall, these results support our hypotheses that constituency statutes lead to a decrease in financial misconduct arising from opportunistic behavior.

[Insert Table 8 Here]

Next, we investigate the impact of adopting constituency statutes on financial misstatements as another form of financial misconduct related to insider trading (Agrawal and Cooper (2015)). Recent studies have focused on the relationship between constituency statutes and earnings management. Gao, Li, and Ma (2021) show that constituency statutes limit earnings

management, while Ni (2020) suggests that they decrease it. Building upon this research, we extend our analysis to explore the effect of constituency statutes on financial misstatements. We use the Dechow et al. (2011) data on the Accounting Enforcement Releases (AAERs) with alleged financial misstatements.[37] Dechow et al. (2011) highlight the advantages of "using the SEC's AAERs as a sample of misstatements" as follows: "the use of AAERs as a proxy for manipulation is a straightforward and consistent methodology" and "AAERs are also likely to capture a group of economically significant manipulations as the SEC has limited resources and likely pursues the most important cases." Dechow et al. (2011) also state that "…the SEC has issued Accounting and Auditing Enforcement Releases (AAERs) during or at the conclusion of an investigation against a company, an auditor, or an officer for alleged accounting and/or auditing misconduct. These releases provide varying degrees of detail on the nature of the misconduct, the individuals and entities involved, and the effect on the financial statements."

We match the annual financial misstatement data with the firms in our sample for the years 1986-2019. For each firm-year, we construct a dummy variable, *AAER Misstatement*, which takes the value of one if there is a financial misstatement in a year and zero otherwise. Next, we investigate the impact of constituency statutes on financial misstatements. We run a logit regression in which the dependent variable is *AAER Misstatement*, and the variable of interest is *Constituency Statutes*.

We present results using all three model specifications in columns 1 through 3 of Table 9. Once again, the coefficient for *Constituency Statutes* is negative and significant in all models. For example, the coefficient is -0.290 in column 1 and is significant at the 5% level. This means that a unit increase in *Constituency Statutes* is associated with a 25% decrease in the probability of

[37] https://sites.google.com/usc.edu/aaerdataset/home

financial misstatement. These results support our fifth hypothesis that the adoption of *Constituency Statutes* in a firm's incorporation state reduces the likelihood of financial misstatements. These findings align with the recent literature, highlighting the effect of constituency statutes in reducing financial misbehavior.

[Insert Table 9 Here]

5. Identification, Endogeneity and Robustness

5.1. Parallel Trends and Bad Controls

Our identification strategy depends on the Differences-in-differences (DiD) method enabled by the staggered adoption of constituency statutes in different states. Therefore it is important to ensure that certain critical assumptions like parallel trends are maintained, and our results are not an artifact of using bad controls. The "bad controls" issue in staggered DiD designs arises when previously treated units are used as controls for later-treated units. This can lead to biased estimates because the control group itself is affected by the treatment.

In this section, we address these concerns using Callaway and Sant'Anna (2021) difference-in-differences estimation method. This method is robust to treatment effect heterogeneity and addresses the bad controls problem by using only not-yet-treated units as controls and by aggregating group-time average treatment effects. It provides clear interpretations of the estimated effects without relying on strong parallel trends assumptions across all periods and groups. The method can also estimate dynamic treatment effects (how the effect changes over time since treatment). In the context of our study, Callaway and Sant'Anna (2021) method ensures that firms in states that adopted constituency statutes earlier are not used as controls for firms in states that adopted them later. It allows for the possibility that the effect of constituency statutes might vary depending on when they were adopted or how long they've been in effect, and it provides a more

accurate picture of how the statutes' effects evolve over time, which is particularly important if one expects the impact on opportunistic trading to change as firms and managers adjust to the new legal environment.

Figure 2 shows the event study dynamic effects for opportunistic purchases around the adoption of constituency statutes (treatment time)[38]. The coefficients represent the average treatment effect on the treated (ATT) by periods around the treatment date for opportunistic purchases[39]. Solid dots represent the ATT coefficients, and the transparent bars represent 95% confidence intervals. Negative (positive) values for post-treatment coefficients indicate a decrease (increase) in opportunistic purchases after the enactment of constituency statutes. The figure reveals that most pre-treatment ATTs are close to zero, in line with the parallel trends assumption. Post-treatment, coefficients shift to below zero over time. Panel B of Figure 2 tests the null hypothesis that all pre-treatment ATTs are zero, and fails to reject it (p-value 0.1632). This shows that the parallel-trends assumption holds as there is no evidence of significant pre-treatment differences between treated and control groups. Panel C tests if the average ATT for the pre-treatment and post-treatment period is zero. The average ATT for the pre-treatment period is statistically indistinguishable from zero, supporting the parallel trends assumption. The average ATT for the post-treatment period is -5.8% and significant at the 10% level, suggesting an overall negative effect of constituency statutes adoption on the probability of opportunistic purchases post-treatment. It is important to note that the strongest effects seem to appear several years after adoption (e.g., years 12 and 13 post-treatment), suggesting a potential delayed impact of the statutes.

[38] Since we do not find significant effects of constituency statutes on sales throughout the paper, we do not repeat this analysis for sales transactions for brevity.

[39] ATT is calculated using the DID estimation method with multiple periods developed by Callaway and Sant'Anna (2021), and implemented using their csdid command in Stata.

These results show that the adoption of constituency statutes is followed by a reduction in purchases in the post-adoption period, and the effect gets stronger over time. Taken together, the analysis in this section shows that our main results are not driven by bad controls or the violation of the parallel trends assumption.

5.2. Probability of constituency statutes adoption.

Next, we use a Cox proportional hazard model to understand the determinants of Constituency Statutes adoption and to ensure that the ex-ante level of insider trading does not trigger the adoption of Constituency Statutes in that state. Table A.2 shows the results. We use a one-year-lagged opportunistic purchase dummy and state-level socio-economic and demographic variables to estimate the hazard ratios for adoption. Results show ex-ante levels of insider trading (lagged opportunistic purchase dummy) do not significantly predict the adoption of constituency statutes. None of the control variables (population, income, education, minority percentage, age 65 and older) significantly predict the adoption of constituency statutes either. This suggests that the adoption of these laws was not driven by existing levels of insider trading.

5.3. Rule 10b5-1 Trades

SEC Rule 10b5-1 allows insiders to set up pre-planned trading programs to buy or sell securities at predetermined times or prices. It is used more frequently for sales than purchases since sales transactions are more frequent due to diversification, portfolio rebalancing, and liquidity reasons. We nevertheless check whether our purchase results are driven by classifying 10b5-1 purchases as opportunistic purchases. We attempt to identify 10b5-1 purchases in our sample. Rule 10b5-1 became effective on October 23rd, 2000. So, we classify all purchases before this date as non-10b5-1 purchases. We then search Form 4 filings for the phrases “10b5-1", "Rule 10b5-1" and "Trading plan". If any of these phrases are present in a Form 4 filing, we label all transactions associated with that particular filing as 10b5-1 transactions. Mandatory electronic filing of insider forms

started on June 30th, 2003, so our search algorithm covers the full universe of Form 4 filings between June 30th, 2003, and March 31st, 2022 (end of our sample). Between October 23rd, 2000, and June 30th, 2003, our search algorithm is applied only to the Form 4 filings that are available electronically. Once we match the search results for Form 4 filings with the transactions in our sample, we are able to calculate 10b5-1 indicator dummy for 213,850 purchase transactions and 638,524 sales transactions. Consistent with our expectation, only 1.4% of purchases are classified as 10b5-1, whereas 20% of sales are 10b5-1 trades. We then exclude these 10b5-1 purchases and re-run our main tests in Table 10, and our results still hold[40]. To check how well our search algorithm is catching 10b5-1 trades, we use Form 4 filings from 2023, when 10b5-1 reporting became mandatory by using a 10b5-1 check box on Form 4. We calculated the 10b5-1 dummy using our search algorithm and also using the dedicated field in Form 4. Our search algorithm classified 8.3% of transactions as 10b5-1 related, whereas dedicated checkbox classified 7% as 10b5-1 related. Our search algorithm correctly captured 87% of the 10b5-1 classified by the dedicated checkbox.

6. Conclusion

In this paper, we examined the impact of stakeholder orientation on opportunistic insider trading by employing staggered adoption of constituency statutes across different U.S. states as a measure of exogenous shock to stakeholder orientation. Constituency statutes allow directors to consider stakeholder interests in their decision-making without violating their fiduciary duties to

[40] Note that the number of observations for purchases and sales regressions in Table 10 are lower, once we require data coverage for all the control variables in the regressions.

the shareholders. We conjecture that increased stakeholder orientation via the adoption of state-level constituency statutes mitigates opportunistic insider trading as a form of managerial financial misconduct.

Our findings provide evidence in favor of the mitigating role of stakeholder orientation induced by constituency statutes on opportunistic insider trading. We find that firms incorporated in states that passed stakeholder constituency statutes show a lower likelihood of opportunistic insider purchases before earnings releases. This reduction in opportunistic purchases is substantial in firms located in states with higher local corruption and in firms with low institutional ownership, no analyst coverage, co-opted boards, and informative stock prices, all factors indicative of high information asymmetry, insider dominated information flow and weak board, shareholder and external monitoring. This suggests that constituency statutes effectively mitigate opportunistic behavior in the absence of other disciplining mechanisms. These findings also support the notion that the mitigating effect of constituency statutes on insider trading comes from stakeholder-oriented constituency statutes rather than other factors.

Analogous to our insider trading results, we find that constituency statutes exhibit a mitigating role using other measures of financial misconduct. We examine securities fraud litigation and find a lower likelihood of securities class action lawsuits in firms incorporated in states that adopted constituency statutes. We observe a similar association between the adoption of constituency statutes and the decreased probability of misconduct when we analyze financial misstatements.

Our empirical findings shed more light on the relationship between stakeholder orientation and opportunistic insider trading. Our paper contributes to the vast literature on financial misconduct by providing a novel insight into the role of legal adoption of the stakeholder statutes

as a mitigating mechanism for insider trading as a form of managerial misconduct and, as such, will be of interest to policymakers and practitioners.

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Figure 1. Stakeholder to Shareholder Word Count Ratio in 10Ks Around Constituency Statutes Adoption

This figure plots the ratio of the count of the word "stakeholder" to the sum of the counts of the words "shareholder" and "stockholder" in all 10-K filings available SEC's Edgar Database from 1994 to December 21st, 2023. We also include plural versions of these words in the word count. We matched the filings to firms that ultimately adopted Constituency Statutes and plotted the ratio below around the adoption year.

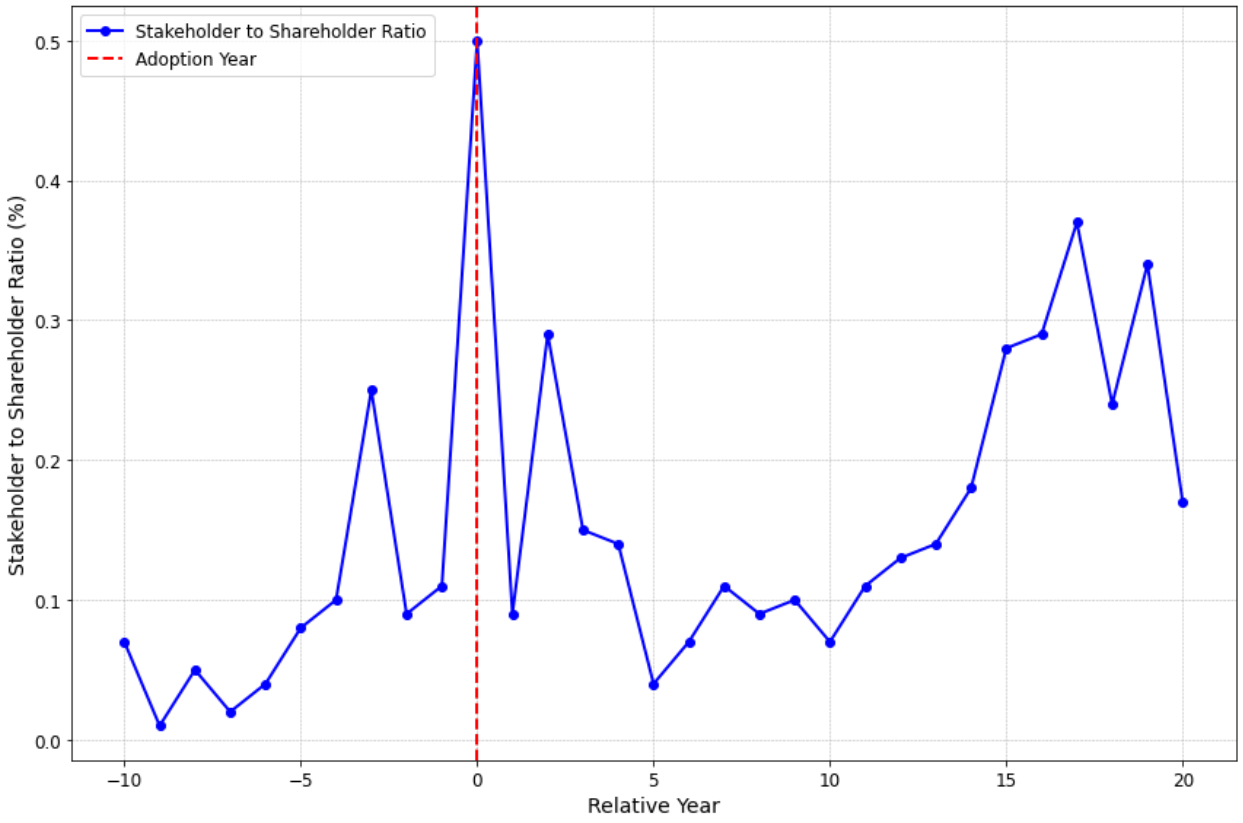
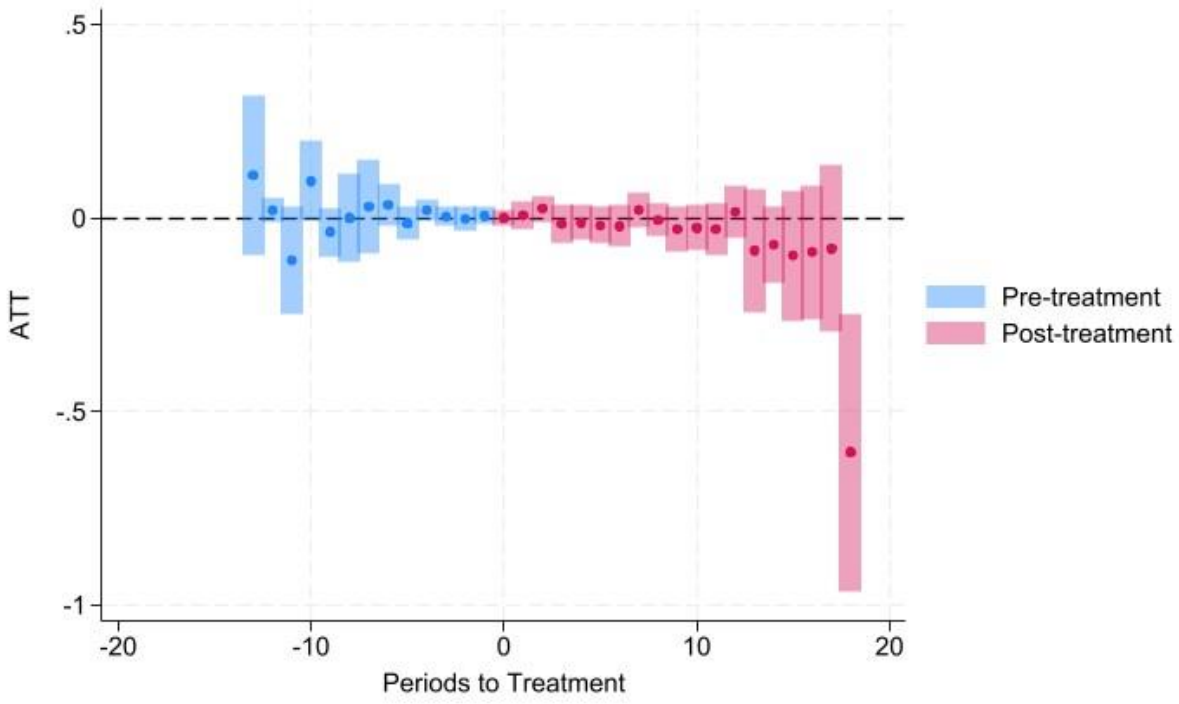


Figure 2 - Event study dynamic effects for opportunistic purchases

Figure in Panel A presents the average treatment effect on treated (ATT) by periods around the treatment date for opportunistic purchases. ATT is calculated using the DID estimation method with multiple periods developed by Callaway and Sant'Anna (2021), and implemented using their csdid command in Stata. Solid dots represent the ATT coefficients, and the transparent bars represent 95% confidence intervals. Negative (positive) values for post-treatment coefficients indicate a decrease (increase) in opportunistic purchases after the enactment of constituency statutes. Panel B tests whether all pre-treatment coefficients are jointly equal to zero to verify the parallel trends assumption. Panel C shows the average of ATT coefficients for pre-treatment and post-treatment periods.

Panel A: Effect on Opportunistic Purchases



Panel B: Pre-trend test to verify parallel trends assumption:		
H0: All Pre-treatment are equal to 0		
chi2(53) = 63.0179		
p-value = 0.1632		
Panel C: Average effects:	**Coef.**	**P-value**
Pre-treatment period	0.012	0.353
Post-treatment period	-0.058*	0.070

Table 1 Descriptive statistics

This table presents the descriptive statistics for the variables used in the main regressions. Variable definitions are in Appendix Table A.1. The insider trading sample includes all direct open market insider sales and purchases from 1983 through 2022. The sample for Accounting and Auditing Enforcement Release (AAER) Misstatements run from 1986-2019, and the sample for Class Action Lawsuit Filings run from 1996 to 2021. Class Action Lawsuit Filing data comes from Stanford Law School's Securities Class Action Clearinghouse (SCAC), and AAER data is from the University of Southern California's Leventhal School of Accounting.

	N	Mean	Std Dev	Q1	Median	Q3
Panel A: Purchases						
Opportunistic Trade dummy	293,484	0.032	0.175	0.000	0.000	0.000
Constituency Statutes dummy	293,484	0.406	0.491	0.000	0.000	1.000
Ln (Mcap)	293,484	12.41	1.97	11.03	12.31	13.64
Ln (B/M)	293,484	-0.520	0.844	-0.897	-0.432	-0.036
Past Return	293,484	-0.003	0.384	-0.199	-0.021	0.137
Past Volatility	293,484	0.529	0.332	0.296	0.441	0.671
Change in Volatility	293,484	0.014	0.296	-0.078	0.003	0.097
Ln (Trade Size)	293,484	9.432	1.988	8.287	9.530	10.731
CEO	293,484	0.121	0.326	0.000	0.000	0.000
CFO	293,484	0.054	0.225	0.000	0.000	0.000
Fraction of Institutional Shareholders	233,324	0.420	0.280	0.183	0.382	0.636
Concentration of Institutional Shareholders	233,324	192.9	200.6	50.1	135.6	269.7
Accruals	233,324	-0.046	0.107	-0.081	-0.030	-0.002
Illiquidity	233,324	0.003	0.018	0.000	0.000	0.001
Number of Analysts	233,324	3.958	5.845	0.000	1.000	6.000
Ln (Population)	232,389	16.09	0.84	15.56	16.12	16.76
Income ($millions)	232,389	0.055	0.040	0.048	0.053	0.061
Education	232,389	0.269	0.059	0.226	0.263	0.306
Minority percentage	232,389	0.189	0.080	0.137	0.182	0.240
Age 65 and older	232,389	0.132	0.023	0.115	0.130	0.144

Table 1 (continued)

	N	Mean	Std Dev	Q1	Median	Q3
Panel B: Sales						
Opportunistic trade dummy	943,470	0.058	0.233	0.000	0.000	0.000
Constituency State	943,470	0.249	0.432	0.000	0.000	0.000
Ln (Mcap)	943,470	14.09	2.06	12.74	14.10	15.44
Ln (B/M)	943,470	-1.141	0.911	-1.600	-1.030	-0.552
Past Return	943,470	0.226	0.585	-0.013	0.138	0.337
Past Volatility	943,470	0.472	0.295	0.281	0.399	0.579
Change in Volatility	943,470	-0.019	0.226	-0.094	-0.016	0.055
Ln (Trade Size)	943,470	12.002	1.822	10.824	12.049	13.225
CEO	943,470	0.123	0.328	0.000	0.000	0.000
CFO	943,470	0.071	0.258	0.000	0.000	0.000
Fraction of Institutional Shareholders	879,473	0.662	0.276	0.475	0.717	0.879
Concentration of Institutional Shareholders	879,473	268.5	192.7	132.5	239.6	363.3
Accruals	879,473	-0.054	0.105	-0.093	-0.047	-0.007
Illiquidity	879,473	0.001	0.008	0.000	0.000	0.000
Number of Analysts	879,473	8.899	8.625	2.000	7.000	14.000
Ln (Population)	877,191	16.30	0.90	15.65	16.32	17.17
Income ($millions)	877,191	0.059	0.046	0.050	0.057	0.065
Education	877,191	0.292	0.062	0.250	0.288	0.332
Minority percentage	877,191	0.199	0.076	0.150	0.199	0.248
Age 65 and older	877,191	0.131	0.022	0.113	0.130	0.144
Panel B: Class Action Lawsuits and Misstatements						
Class Action Lawsuit Filings	122,547	0.032	0.175	0.000	0.000	0.000
AAER Misstatements	168,255	0.007	0.082	0.000	0.000	0.000

Table 2. Main Tests

The main variable of interest is *Constituency Statutes* dummy which is set to one if the firm's state of incorporation is a constituency statutes state for the current year. The dependent variable is opportunistic trade dummy which is set to one if it is made by an insider who is in the top quintile of the profitability ranking of past trades before earnings announcements. Columns 1 to 3 reports results for purchases, and columns 4 to 6 for sales. All other variable definitions are in Appendix Table A.1. All tests include industry and year dummy variables. Industries are defined using Fama-French 49 industries. Standard errors are adjusted for heteroskedasticity and clustered at the incorporation state level. Robust *p*-values are in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels respectively.

	Opportunistic Purchases			Opportunistic Sales		
VARIABLES	(1)	(2)	(3)	(4)	(5)	(6)
Constituency Statutes	-0.167**	-0.252***	-0.286***	-0.057	-0.005	0.012
	(0.028)	(0.001)	(0.001)	(0.393)	(0.942)	(0.865)
Ln (Mcap)	-0.073***	-0.066**	-0.063**	-0.084***	-0.110***	-0.109***
	(0.000)	(0.015)	(0.021)	(0.000)	(0.000)	(0.000)
Ln (B/M)	-0.035	0.008	0.009	0.010	0.019	0.020
	(0.476)	(0.852)	(0.823)	(0.406)	(0.167)	(0.173)
Past Return	-0.063	-0.098*	-0.098*	-0.067***	-0.051***	-0.050***
	(0.218)	(0.097)	(0.089)	(0.001)	(0.005)	(0.005)
Past Volatility	0.036	-0.089	-0.086	0.221**	0.228**	0.228**
	(0.781)	(0.533)	(0.503)	(0.014)	(0.029)	(0.021)
Change in Volatility	-0.010	0.023	0.018	-0.059	-0.061	-0.060
	(0.831)	(0.764)	(0.802)	(0.191)	(0.242)	(0.230)
Ln (Trade Size)	0.086***	0.101***	0.103***	-0.036***	-0.044***	-0.043***
	(0.001)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
CEO	0.679***	0.642***	0.658***	0.316***	0.324***	0.317***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
CFO	-0.302**	-0.324**	-0.304**	0.141***	0.146***	0.147***
	(0.013)	(0.021)	(0.026)	(0.000)	(0.000)	(0.000)
Fraction		-0.394	-0.411*		0.301***	0.282***
		(0.103)	(0.094)		(0.000)	(0.001)
Concentration		-0.000**	-0.000**		0.000	0.000
		(0.011)	(0.020)		(0.143)	(0.129)
Accruals		0.232	0.186		-0.263**	-0.247*
		(0.217)	(0.347)		(0.046)	(0.060)
Illiquidity		1.510	1.383		-3.418**	-3.388**
		(0.313)	(0.368)		(0.025)	(0.030)
Number of Analysts		0.015	0.015		0.004	0.004
		(0.193)	(0.196)		(0.133)	(0.149)
Ln (Population)			-0.025			-0.016
			(0.555)			(0.575)
Income			0.013			-0.126
			(0.834)			(0.414)
Education			-2.344**			0.579
			(0.030)			(0.351)
Minority percentage			0.328			-0.058
			(0.497)			(0.868)
Age 65 and older			3.734*			-2.074
			(0.069)			(0.274)
Constant	-2.108**	-2.697**	-1.967	-2.755***	-2.591***	-2.120**
	(0.032)	(0.015)	(0.145)	(0.000)	(0.000)	(0.016)
Observations	293,484	233,324	232,389	943,470	879,473	877,191
Pseudo R-squared	0.0395	0.0402	0.0415	0.0267	0.0254	0.0256

Table 3. Local Corruption Tests

The main variable of interest is the *Constituency Statutes* dummy, which is set to one if the firm's state of incorporation is a constituency statutes state for the current year. The dependent variable is an opportunistic trade dummy which is set to one if it is made by an insider who is in the top quintile of the profitability ranking of past trades before earnings announcements. In this table, we re-examine the main tests in Table 2 for low and high corruption subsamples separately. Columns 1 and 2 report results for purchases for firms headquartered in low-corruption and high-corruption states, respectively. Columns 3 and 4 report results for sales for firms headquartered in low-corruption and high-corruption states, respectively. A state is designated as a low (high) corruption state if conviction rates per capita in a given year are below (above) the median conviction rate per capita for all states in that year. We use state-level corruption data provided on Alex Butler's Website for conviction rate per capita. All other variable definitions are in Appendix 1. All the tests include industry and year dummy variables. Industries are defined using Fama-French 49 industries. Standard errors are adjusted for heteroskedasticity and clustered at the incorporation state level. Robust *p*-values are in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels respectively.

Dependent Variable: Opportunistic trade dummy	(1) Opportunistic Purchases- Low Corruption	(2) Opportunistic Purchases- High Corruption	(3) Opportunistic Sales- Low Corruption	(4) Opportunistic Sales- High Corruption
Constituency Statutes	-0.178	-0.355***	0.065	0.002
	(0.121)	(0.001)	(0.549)	(0.980)
Ln (Mcap)	-0.052	-0.050*	-0.112***	-0.119***
	(0.264)	(0.051)	(0.000)	(0.000)
Ln (B/M)	-0.025	0.063	0.002	0.080**
	(0.813)	(0.255)	(0.924)	(0.031)
Past Return	-0.192	-0.064	-0.067***	-0.030
	(0.136)	(0.276)	(0.001)	(0.528)
Past Volatility	-0.231	0.003	0.250	0.156
	(0.231)	(0.989)	(0.200)	(0.242)
Change in Volatility	0.002	0.030	-0.174	-0.076
	(0.983)	(0.807)	(0.128)	(0.279)
Ln (Trade Size)	0.110***	0.098***	-0.060***	-0.027***
	(0.000)	(0.009)	(0.003)	(0.001)
CEO	0.757***	0.587***	0.320**	0.399***
	(0.000)	(0.003)	(0.013)	(0.000)
CFO	-0.335*	-0.314**	0.048	0.201***
	(0.052)	(0.019)	(0.347)	(0.000)
Fraction	-0.413	-0.711**	0.361***	0.354***
	(0.213)	(0.018)	(0.000)	(0.009)
Concentration	-0.000	-0.001	0.000***	-0.000*
	(0.256)	(0.105)	(0.001)	(0.053)
Accruals	0.287	0.288	-0.142	-0.256
	(0.290)	(0.202)	(0.615)	(0.423)
Illiquidity	2.385*	0.911	-2.604	-4.571**
	(0.087)	(0.655)	(0.147)	(0.031)
Number of Analysts	0.005	0.025*	0.008*	-0.001
	(0.745)	(0.053)	(0.092)	(0.696)
Ln (Population)	-0.075	-0.025	-0.055	-0.023
	(0.306)	(0.758)	(0.119)	(0.490)
Income	0.004	12.177	-0.272	18.792***
	(0.980)	(0.176)	(0.215)	(0.005)
Education	-4.253***	-3.206	-0.201	-0.724
	(0.001)	(0.167)	(0.895)	(0.502)
Minority percentage	0.885*	-0.470	-0.105	-0.111
	(0.054)	(0.490)	(0.902)	(0.653)
Age 65 and older	4.111	2.394	-6.877**	-0.019
	(0.185)	(0.325)	(0.021)	(0.994)
Constant	-2.476	-1.577	-2.447*	-2.336**
	(0.187)	(0.410)	(0.067)	(0.036)
Observations	96,295	117,894	414,318	373,374
Pseudo R-squared	0.0615	0.0529	0.0321	0.0310

Table 4. Institutional Ownership Tests

The main variable of interest is the *Constituency Statutes* dummy, which is set to one if the firm's state of incorporation is a constituency statutes state for the current year. The dependent variable is an opportunistic trade dummy which is set to one if it is made by an insider who is in the top quintile of the profitability ranking of past trades before earnings announcements. In this table, we re-examine the main tests in Table 2 for high and low institutional ownership subsamples separately. Columns 1 and 2 report results for purchases for firms with high institutional ownership and low institutional ownership, respectively. Columns 3 and 4 report results for sales for firms with high institutional ownership and low institutional ownership, respectively. A firm is designated as a low (high) institutional ownership firm if institutional investors hold less (more) than 50% of the shares outstanding. Institutional ownership data comes from Thomson Reuters' S34 database. All other variable definitions are in Appendix Table A.1. All the tests include industry and year dummy variables. Industries are defined using Fama-French 49 industries. Standard errors are adjusted for heteroskedasticity and clustered at the incorporation state level. Robust *p*-values are in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels respectively.

Dependent Variable: Opportunistic trade dummy	(1) Opportunistic Purchases- High Inst. Ownership	(2) Opportunistic Purchases- Low Inst. Ownership	(3) Opportunistic Sales- High Inst. Ownership	(4) Opportunistic Sales- Low Inst. Ownership
Constituency Statutes	-0.074	-0.400***	0.019	-0.002
	(0.667)	(0.000)	(0.812)	(0.978)
Ln (Mcap)	-0.014	-0.063**	-0.100***	-0.139***
	(0.686)	(0.030)	(0.000)	(0.000)
Ln (B/M)	-0.145***	0.064	0.038	-0.024
	(0.005)	(0.367)	(0.262)	(0.728)
Past Return	-0.130	-0.104	-0.081***	-0.041
	(0.223)	(0.127)	(0.002)	(0.159)
Past Volatility	0.148	-0.149	0.422***	-0.046
	(0.666)	(0.220)	(0.000)	(0.698)
Change in Volatility	-0.101	0.041	-0.222***	0.202***
	(0.680)	(0.523)	(0.000)	(0.000)
Ln (Trade Size)	0.068	0.110***	-0.041***	-0.047**
	(0.276)	(0.000)	(0.000)	(0.016)
CEO	0.921***	0.505***	0.324***	0.291***
	(0.000)	(0.000)	(0.001)	(0.000)
CFO	0.032	-0.574***	0.164***	0.050
	(0.857)	(0.000)	(0.000)	(0.706)
Fraction	-0.407	-1.110**	-0.009	0.327
	(0.474)	(0.024)	(0.943)	(0.117)
Concentration	-0.001***	0.001*	0.000**	-0.001***
	(0.000)	(0.088)	(0.033)	(0.000)
Accruals	0.193	0.066	-0.419**	-0.075
	(0.469)	(0.796)	(0.042)	(0.754)
Illiquidity	12.743***	0.983	-6.021	-3.217**
	(0.003)	(0.537)	(0.177)	(0.046)
Number of Analysts	0.006	0.007	0.003	0.008
	(0.636)	(0.598)	(0.383)	(0.455)
Ln (Population)	0.021	-0.058	-0.021	-0.017
	(0.836)	(0.205)	(0.492)	(0.753)
Income	-0.427	0.100	-0.158	-4.165
	(0.685)	(0.343)	(0.240)	(0.590)
Education	-2.223**	-2.137	0.291	2.427
	(0.023)	(0.120)	(0.659)	(0.213)
Minority percentage	0.760	0.057	-0.197	0.542
	(0.205)	(0.940)	(0.582)	(0.328)
Age 65 and older	4.560	4.254*	-3.437**	1.839
	(0.123)	(0.099)	(0.039)	(0.491)
Constant	-4.119*	-1.597	-1.069	-5.624***
	(0.064)	(0.269)	(0.256)	(0.000)
Observations	87,296	144,716	639,930	236,862
Pseudo R-squared	0.0647	0.0571	0.0277	0.0366

Table 5. Analyst Coverage Tests

The main variable of interest is the *Constituency Statutes* dummy, which is set to one if the firm's state of incorporation is a constituency statutes state for the current year. The dependent variable in Panel A is an opportunistic trade dummy which is set to one if it is made by an insider who is in the top quintile of the profitability ranking of past trades before earnings announcements. In this table, we re-examine the main tests in Table 2 for firms with no analyst coverage and firms with analyst coverage subsamples separately. Columns 1 and 2 report results for purchases for firms with analyst coverage and for firms with no analyst coverage. Columns 3 and 4 report results for sales for firms with analyst coverage and for firms with no analyst coverage. Analyst coverage data comes from the IBES database. All other variable definitions are in Appendix Table A.1. All the tests include industry and year dummy variables. Industries are defined using Fama-French 49 industries. Standard errors are adjusted for heteroskedasticity and clustered at the firm level. Robust *p*-values are in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels respectively.

	(1)	(2)	(3)	(4)
Dependent Variable: Opportunistic trade dummy	Opportunistic Purchases- With Analyst Coverage	Opportunistic Purchases- No Analyst Coverage	Opportunistic Sales- With Analyst Coverage	Opportunistic Sales - No Analyst Coverage
Constituency Statutes	-0.175	-0.391***	0.018	-0.013
	(0.116)	(0.002)	(0.825)	(0.887)
Ln (Mcap)	0.013	-0.053*	-0.085***	-0.172***
	(0.714)	(0.090)	(0.000)	(0.000)
Ln (B/M)	-0.023	0.022	0.015	0.026
	(0.631)	(0.812)	(0.376)	(0.481)
Past Return	-0.089	-0.177**	-0.044**	-0.054*
	(0.281)	(0.034)	(0.016)	(0.089)
Past Volatility	0.002	-0.091	0.328***	-0.000
	(0.992)	(0.467)	(0.000)	(1.000)
Change in Volatility	-0.052	0.023	-0.142***	0.139
	(0.792)	(0.752)	(0.000)	(0.219)
Ln (Trade Size)	0.109***	0.099***	-0.046***	-0.028
	(0.002)	(0.000)	(0.000)	(0.380)
CEO	0.846***	0.453***	0.305***	0.370***
	(0.000)	(0.000)	(0.000)	(0.000)
CFO	0.011	-0.677***	0.104***	0.284***
	(0.941)	(0.000)	(0.000)	(0.001)
Fraction	-0.027	-0.638	0.188*	0.732***
	(0.914)	(0.169)	(0.063)	(0.000)
Concentration	-0.001*	-0.000	0.000*	-0.000
	(0.082)	(0.225)	(0.067)	(0.977)
Accruals	0.255	0.078	-0.116	-0.734***
	(0.525)	(0.719)	(0.411)	(0.009)
Illiquidity	5.857*	0.919	-8.101	-3.183**
	(0.083)	(0.551)	(0.235)	(0.022)
Ln (Population)	-0.042	0.020	-0.003	-0.051
	(0.428)	(0.716)	(0.892)	(0.395)
Income	-4.092	0.062	-0.129	-5.814
	(0.436)	(0.516)	(0.345)	(0.297)
Education	-0.921	-3.064	0.896	0.069
	(0.500)	(0.134)	(0.132)	(0.965)
Minority percentage	0.262	0.084	-0.229	0.536
	(0.634)	(0.919)	(0.522)	(0.257)
Age 65 and older	0.915	6.367***	-2.415	-0.656
	(0.721)	(0.001)	(0.177)	(0.797)
Constant	-3.955**	-2.270	-2.436**	-1.154
	(0.034)	(0.278)	(0.019)	(0.492)
Observations	132,091	99,748	687,011	190,122
Pseudo R-squared	0.0456	0.0674	0.0277	0.0371

Table 6 Co-opted Boards

The main variable of interest is the *Constituency Statutes* dummy, which is set to one if the firm's state of incorporation is a constituency statutes state for the current year. The dependent variable is an opportunistic trade dummy, which is set to one if it is made by an insider who is in the top quintile of the profitability ranking of past trades before earnings announcements. In this table, we re-examine the main tests in Table 2 for firms with co-opted boards and firms that do not have co-opted boards. We use the co-option independence ratio measure of Coles, Daniel, and Naveen (2014), which is the ratio of independent directors appointed by the incumbent CEO to the number of board members. Firms with co-opted (not-co-opted) boards have higher (lower) than median co-option independence ratio. Columns 1 and 2 report results for purchases for firms that do not have co-opted boards and for firms that have co-opted boards. Columns 3 and 4 report results for sales for firms that do not have co-opted boards and for firms that have co-opted boards. All other variable definitions are in Appendix Table A.1. All the tests include industry and year dummy variables. Industries are defined using Fama-French 49 industries. Standard errors are adjusted for heteroskedasticity and clustered at the firm level. Robust *p*-values are in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels respectively.

Dependent Variable: Opportunistic trade dummy	(1) Opportunistic Purchases-Not Co-opted	(2) Opportunistic Purchases-Co-opted	(3) Opportunistic Sales-Not Co-opted	(4) Opportunistic Sales-Co-opted
Constituency Statutes	0.098	-0.746***	-0.118	0.076
	(0.521)	(0.010)	(0.222)	(0.520)
Ln (Mcap)	-0.088	0.015	-0.195***	-0.245***
	(0.139)	(0.771)	(0.000)	(0.000)
Ln (B/M)	-0.225***	0.021	0.031	-0.054
	(0.001)	(0.874)	(0.462)	(0.450)
Past Return	-0.338***	-0.105	-0.033	-0.081
	(0.003)	(0.547)	(0.445)	(0.392)
Past Volatility	1.178***	0.499	0.795***	0.315
	(0.001)	(0.614)	(0.000)	(0.236)
Change in Volatility	-0.475	-0.904**	-0.141	-0.345***
	(0.183)	(0.027)	(0.110)	(0.001)
Ln (Trade Size)	-0.037	0.113**	0.015	-0.082***
	(0.573)	(0.029)	(0.141)	(0.000)
CEO	0.559***	1.394***	0.210*	0.365***
	(0.005)	(0.000)	(0.053)	(0.000)
CFO	-0.396	-0.003	0.191***	0.146**
	(0.172)	(0.991)	(0.001)	(0.031)
Fraction	0.735	-1.876***	-0.188	-0.083
	(0.269)	(0.000)	(0.275)	(0.791)
Concentration	-0.001	0.000	0.001***	0.000
	(0.188)	(0.699)	(0.004)	(0.369)
Accruals	0.253	1.585**	-0.396**	0.205
	(0.776)	(0.012)	(0.028)	(0.398)
Illiquidity	67.203*	46.471	-27.876	-199.763
	(0.092)	(0.196)	(0.913)	(0.585)
Number of Analysts	0.090	-0.049	0.110***	-0.093
	(0.393)	(0.742)	(0.010)	(0.135)
Ln (Population)	-0.182	1.028**	-0.158	-0.035
	(0.606)	(0.011)	(0.165)	(0.577)
Income	1.125	-3.569**	0.732	0.443
	(0.395)	(0.021)	(0.564)	(0.697)
Education	-1.192	2.038**	0.085	-0.541
	(0.287)	(0.043)	(0.856)	(0.336)
Minority percentage	3.628	3.680	2.791**	-2.839
	(0.545)	(0.464)	(0.025)	(0.382)
Constant	-4.629**	-2.979	-3.382***	2.270
	(0.012)	(0.185)	(0.008)	(0.243)
Observations	27,701	18,304	178,375	169,753
Pseudo R-squared	0.0727	0.198	0.0384	0.0445

Table 7 Price Informativeness

The main variable of interest is the *Constituency Statutes* dummy, which is set to one if the firm's state of incorporation is a constituency statutes state for the current year. The dependent variable is an opportunistic trade dummy, which is set to one if it is made by an insider who is in the top quintile of the profitability ranking of past trades before earnings announcements. In this table, we re-examine the main tests in Table 2 for firms with high-price informativeness and firms with low-price informativeness. Price informativeness is measured by the probability of informed trading (PIN) calculated using the Venter and de Jongh model (Venter and De Jongh (2006)), and made available by Stephen Brown. PIN data is annual and available for the 1993-2010 period. High levels of PIN indicate that prices are more informative. Firms with informative (not-informative) stock prices have higher (lower) than median PIN. Columns 1 and 2 report results for purchases for firms that do not have informative prices and for firms that have informative prices. Columns 3 and 4 report results for sales for firms that do not have informative prices and for firms that have informative prices. All other variable definitions are in Appendix Table A.1. All the tests include industry and year dummy variables. Industries are defined using Fama-French 49 industries. Standard errors are adjusted for heteroskedasticity and clustered at the firm level. Robust *p*-values are in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels respectively.

	(1)	(2)	(3)	(4)
Dependent Variable:	Purchases-	Purchases-	Sales-	Sales-
Opportunistic trade dummy	Not Informative	Informative	Not Informative	Informative
Constituency Statutes	-0.323	-0.467***	0.095	0.133
	(0.115)	(0.000)	(0.330)	(0.129)
Ln (Mcap)	0.032	-0.156***	-0.203***	-0.076***
	(0.517)	(0.000)	(0.000)	(0.006)
Ln (B/M)	-0.101**	0.053	-0.016	0.147***
	(0.041)	(0.620)	(0.706)	(0.000)
Past Return	-0.108*	-0.080	-0.033	-0.072*
	(0.088)	(0.460)	(0.252)	(0.065)
Past Volatility	0.412	-0.594***	-0.209	0.126
	(0.293)	(0.001)	(0.287)	(0.520)
Change in Volatility	-0.186	0.295***	0.027	-0.112
	(0.431)	(0.006)	(0.855)	(0.339)
Ln (Trade Size)	0.109**	0.077***	-0.068***	-0.025
	(0.014)	(0.004)	(0.000)	(0.322)
CEO	1.101***	0.569***	0.260*	0.577***
	(0.000)	(0.000)	(0.065)	(0.000)
CFO	0.227	-0.589***	-0.073	0.119
	(0.368)	(0.001)	(0.296)	(0.431)
Fraction	-0.529**	-0.800**	0.296*	0.638***
	(0.032)	(0.036)	(0.056)	(0.007)
Concentration	-0.000	-0.000	0.000	-0.000
	(0.469)	(0.201)	(0.166)	(0.231)
Accruals	0.547	0.046	0.070	-0.205
	(0.510)	(0.879)	(0.851)	(0.692)
Illiquidity	-42.148	1.008	-34.073	-7.489***
	(0.264)	(0.555)	(0.240)	(0.001)
Number of Analysts	-0.033	-0.094	-0.090	-0.013
	(0.812)	(0.212)	(0.186)	(0.806)
Ln (Population)	26.846***	-0.565	1.836	-3.874
	(0.005)	(0.953)	(0.739)	(0.749)
Income	-8.009***	-1.657	0.181	-0.078
	(0.000)	(0.558)	(0.912)	(0.963)
Education	0.586	0.819	-0.025	0.756*
	(0.505)	(0.265)	(0.926)	(0.093)
Minority percentage	1.598	6.771***	-1.383	-2.315
	(0.697)	(0.000)	(0.444)	(0.424)
Constant	-4.120	-1.384	0.810	-4.899***
	(0.119)	(0.498)	(0.465)	(0.002)
Observations	39,634	97,171	273,447	180,541
Pseudo R-squared	0.0849	0.0618	0.0343	0.0395

Table 8. Class Action Filings

The dependent variable is *Class Action Filing*, which takes the value of one if there is a securities class action lawsuit filed in a year and zero otherwise. Class Action Filing data comes from Stanford Law School's Securities Class Action Clearinghouse (SCAC). The main variable of interest is the *Constituency Statutes* dummy, which is set to one if the firm's state of incorporation is a constituency statutes state for the current year. All other variable definitions are in Appendix Table A.1. The regression includes industry and year dummy variables. Industries are defined using Fama-French 49 industries. Standard errors are adjusted for heteroskedasticity and clustered at the incorporation state level. Robust *p*-values are in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels respectively.

Dependent Variable: Class Action Filing	(1)	(2)	(3)
Constituency Statutes	-0.335***	-0.237***	-0.226***
	(0.000)	(0.002)	(0.001)
Ln (Mcap)	0.290***	0.176***	0.175***
	(0.000)	(0.000)	(0.000)
Ln (B/M)	-0.083***	-0.082***	-0.086***
	(0.000)	(0.000)	(0.000)
Past Return	-0.519***	-0.409***	-0.408***
	(0.000)	(0.000)	(0.000)
Past Volatility	0.649***	0.923***	0.922***
	(0.000)	(0.000)	(0.000)
Change in Volatility	-0.109***	-0.187***	-0.187***
	(0.000)	(0.006)	(0.009)
Fraction		0.382***	0.424***
		(0.000)	(0.000)
Concentration		-0.000	-0.000
		(0.925)	(0.850)
Accruals		0.893***	0.864***
		(0.000)	(0.000)
Illiquidity		-150.702**	-145.622**
		(0.016)	(0.018)
Number of Analysts		0.018***	0.017***
		(0.000)	(0.000)
Ln (Population)			0.070***
			(0.003)
Income			-0.137
			(0.617)
Education			-0.005
			(0.118)
Minority percentage			0.003
			(0.459)
Age 65 and older			0.007
			(0.635)
Constant	-8.395***	-7.189***	-8.389***
	(0.000)	(0.000)	(0.000)
Observations	122,547	98,902	98,282
Pseudo R-squared	0.0890	0.0912	0.0930

Table 9. Financial Misstatements

The dependent variable is *AAER Misstatement*, which takes the value of one if there is a financial misstatement in a year and zero otherwise. AAER data is from the University of Southern California's Leventhal School of Accounting and runs from 1986 to 2019. The main variable of interest is the *Constituency Statutes* dummy, which is set to one if the firm's state of incorporation is a constituency statutes state for the current year. All other variable definitions are in Appendix Table A.1. The regression includes industry and year dummy variables. Industries are defined using Fama-French 49 industries. Standard errors are adjusted for heteroskedasticity and clustered at the incorporation state level. Robust *p*-values are in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels respectively.

Dependent Variable: AAER Misstatement	(1)	(2)	(3)
Constituency Statutes	-0.290**	-0.280**	-0.301**
	(0.029)	(0.039)	(0.040)
Ln (Mcap)	0.308***	0.267***	0.257***
	(0.000)	(0.000)	(0.000)
Ln (B/M)	-0.038	-0.031	-0.029
	(0.463)	(0.632)	(0.638)
Past Return	0.126***	0.162***	0.161***
	(0.005)	(0.003)	(0.006)
Past Volatility	0.267***	0.117	0.066
	(0.000)	(0.120)	(0.353)
Change in Volatility	-0.086**	0.019	-0.048
	(0.035)	(0.762)	(0.304)
Fraction		0.990***	0.972***
		(0.000)	(0.000)
Concentration		-0.001***	-0.001***
		(0.000)	(0.000)
Accruals		1.892***	1.800***
		(0.000)	(0.000)
Illiquidity		-1.585	-1.042
		(0.766)	(0.843)
Number of Analysts		-0.009**	-0.007*
		(0.011)	(0.066)
Ln (Population)			-0.010
			(0.780)
Income			-0.270
			(0.706)
Education			0.008
			(0.544)
Minority percentage			0.011
			(0.126)
Age 65 and older			0.051**
			(0.023)
Constant	-9.284***	-10.177***	-10.790***
	(0.000)	(0.000)	(0.000)
Observations	168,255	130,726	130,155
Pseudo R-squared	0.0978	0.111	0.111

Table 10. Robustness of main results - excluding trades made under a 10b5-1 plan

The main variable of interest is the *Constituency Statutes* dummy, which is set to one if the firm's state of incorporation is a constituency statutes state for the current year. The dependent variable is the opportunistic trade dummy, which is set to one if it is made by an insider who is in the top quintile of the profitability ranking of past trades before earnings announcements. We only include those trades for which the associated Form 4s do not contain any of the following words or phrases: "10b5-1", "Rule 10b5-1", "Trading plan". Column 1 reports results for purchases, and Column 2 for sales. All other variable definitions are in Appendix Table A.1. All the tests include industry and year dummy variables. Industries are defined using Fama-French 49 industries. Standard errors are adjusted for heteroskedasticity and clustered at the incorporation state level. Robust *p*-values are in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels respectively.

Dependent Variable: Opportunistic trade dummy	(1) OppPurchases	(2) OppSales
Constituency Statutes	-0.235**	0.065
	(0.024)	(0.428)
Ln (Mcap)	-0.064**	-0.143***
	(0.015)	(0.000)
Ln (B/M)	0.039	0.026
	(0.519)	(0.516)
Past Return	-0.070	-0.017
	(0.251)	(0.511)
Past Volatility	-0.093	-0.010
	(0.522)	(0.942)
Change in Volatility	0.048	0.061
	(0.600)	(0.508)
Ln (Trade Size)	0.097***	0.011
	(0.003)	(0.351)
CEO	0.668***	0.327***
	(0.000)	(0.000)
CFO	-0.376***	0.161
	(0.006)	(0.216)
Fraction	-0.698***	0.104
	(0.009)	(0.522)
Concentration	-0.000	-0.000
	(0.470)	(0.595)
Accruals	0.050	0.153
	(0.828)	(0.242)
Illiquidity	2.124	-2.661
	(0.122)	(0.136)
Number of Analysts	0.019	0.001
	(0.119)	(0.789)
Ln (Population)	-0.035	-0.031
	(0.445)	(0.465)
Income	0.627**	-0.542
	(0.016)	(0.131)
Education	-3.045**	-1.140**
	(0.011)	(0.030)
Minority percentage	0.677	-0.188
	(0.212)	(0.716)
Age 65 and older	3.770	-1.964
	(0.158)	(0.557)
Constant	-1.910	-1.025
	(0.257)	(0.510)
Observations	163,042	455,699
Pseudo R-squared	0.0445	0.0219

Table A.1 Variable Definitions

Ln (B/M): Log of the book to market ratio is calculated using quarterly COMPUSTAT data items as follows: bm=ceqq/(cshoq* prccq). Data comes as of the fiscal quarter end immediately preceding the beginning of the current month (during which the trade takes place) minus three months. If cshoq* prccq is missing, then the market value of equity is calculated using CRSP data as price times the number of shares outstanding. In Tables 7 and 8, data comes from the most recent fiscal quarter-end three months before the beginning of the year.

Ln (Mcap): Log of market capitalization as of the trading date using the most recent month-end data for price and shares outstanding. In Tables 7 and 8, it is calculated at the end of the previous year.

Past Return: Stock return during the six-month period ending right before the beginning of the current month. In Tables 7 and 8, past return is the return for the last six months of the preceding year.

Past Volatility: Annualized stock return volatility using daily returns during the six-month period preceding the current month. In Tables 7 and 8, stock volatility is the volatility for the last six months of the preceding year.

Change in Volatility: Past Volatility minus the annualized stock return volatility using daily returns during the six-month period preceding the month -6 relative to the current month (month 0). In Tables 7 and 8, change in volatility is the volatility for the last six months of the preceding year minus the volatility for the first six months of the preceding year.

Ln (Trade Size): Log of the absolute dollar value of the trade (in 2022 dollars).

CEO: Dummy variable that is set to one if the insider is the Chief Executive officer (CEO).

CFO: Dummy variable that is set to one if the insider is the Chief Executive officer (CEO).

Fraction: Percentage of institutional shareholders obtained from Thomson Reuters S34 database. It is measured as of the most recent fiscal quarter end immediately preceding the beginning of the year minus three months.

Concentration: Concentration of institutional shareholders is calculated as the Herfindahl index of institutional ownership shares from Thomson Reuters S34 database.

Accruals: Working capital accruals calculated as annual income before extraordinary items (*ib*) minus operating cash flows (*oancf*) divided by average total assets (*at*); if *oancf* is missing then set to change in *act* - change in *che* - change in *lct* + change in *dlc* + change in *txp-dp*.

Illiquidity: Amihud (2002) illiquidity measure calculated as average of daily (absolute return / dollar volume).

Number of Analysts: Number of analysts covering the firm, obtained from IBES database. It is measured as of the most recent month end immediately preceding the beginning of the year minus three months.

Ln Pop: Natural logarithm of the population of the headquarter state obtained from US CENSUS database.

Income: Real personal income per capita (2022 dollars) constructed using US CENSUS data.

Education: Percentage of individuals 25 years and over holding a college degree in a given the headquarters state from the US CENSUS database.

Minority percentage: Percentage of non-white population from US CENSUS database.

Age 65 and older: Percentage of population aged 65 and older from US CENSUS database.

Opportunistic trade based on Quarterly Earnings Announcement (QEA) date: Dummy variable showing if the trade belongs to an insider who is labeled as opportunistic for the year based on their trading in previous years before the QEA dates. An insider is labeled as opportunistic for a given year if they are in the top quintile of average profitability of all their insider trading during days -21 through -3 relative to the QEA dates in all of the previous years. For each of these pre-QEA trades, we calculate profitability as the average market-adjusted return for the QEA period (days -2 through +2 relative to the QEA day):

$$\text{Profit} = \sum_{j=-2}^{j=2}(r_{(i,t+j)} - r_{m,t+j})/5 \qquad (1)$$

where t is the QEA date, $r_{i,t}$ is stock i 's return on day t, and $r_{m,t}$ is the return on the CRSP equal-weighted index on day t. Then for each year and for each insider, we define the average profitability of the insider's past pre-QEA trades as:

$$\text{Average Profit} = (\sum^{B} Profit_{Buy} - \sum^{S} Profit_{sell})/(B+S) \quad (2)$$

where B (S) is the total number of pre-QEA buy (sell) trades made by the insider prior to the start of the year. If an insider makes multiple trades in a particular pre-QEA period, we aggregate the trades and classify them as a buy (sell) trade if the number of shares bought is greater (less) than the number of shares sold by the insider during the pre-QEA period.

Constituency Statutes: Dummy variable showing if the firm's state of incorporation is a constituency state in the current year. Data on the adoption of constituency statutes by the state is from Gao, Li, and Ma (2021).

Table A.2. List of States Which have Adopted Constituency Statutes

This table shows the years when constituency statutes became effective in different U.S. states. The list is from Table 2 in Karpoff and Wittry (2018) .

State	Year
Ohio	1984
Illinois	1985
Maine	1985
Indiana	1986
Missouri	1986
Arizona	1987
Minnesota	1987
New Mexico	1987
New York	1987
Wisconsin	1987
Connecticut	1988
Idaho	1988
Kentucky	1988
Louisiana	1988
Nebraska	1988, 2007
Tennessee	1988
Virginia	1988
Florida	1989
Georgia	1989
Hawaii	1989
Iowa	1989
Massachusetts	1989
New Jersey	1989
Oregon	1989
Mississippi	1990
Pennsylvania	1990
Rhode Island	1990
South Dakota	1990
Wyoming	1990
Nevada	1991
North Carolina	1993
North Dakota	1993
Vermont	1998
Maryland	1999
Texas	2006

Table A3. Determinants of the Adoption of Constituency Statutes

This table shows results from the Cox proportional hazard model testing the effect of past opportunistic insider purchases of firms incorporated in the state, and past state-level socioeconomic variables on the adoption of constituency statutes in that state. We use one-year-lagged versions of our opportunistic purchase dummy and incorporation state-level socioeconomic variables. The Cox model shows how each variable affects the hazard (risk) of a state adopting the constituency statute. The coefficient on the Opportunistic purchase dummy (lagged one year) is of particular interest. If that coefficient is not statistically significant, this suggests that the ex-ante level of insider trading does not trigger law adoption.

	Hazard Ratios for Adoption
Opportunistic purchase dummy (lagged one-year)	1.100
	(0.973)
Ln (Population) (lagged one-year)	1.251
	(0.217)
Income (lagged one-year)	1.830
	(0.124)
Education (lagged one-year)	0.8989
	(0.200)
Minority percentage (lagged one-year)	0.998
	(0.925)
Age 65 and older (lagged one-year)	1.088
	(0.385)
Observations (incorporation state-year level)	737
LR chi2(6)	7.16
Prob>chi2	0.307
Global test of proportional-hazards assumption (p-value)	0.872