

LAWYERS IN THE EXECUTIVE SUITE: GATEKEEPERS AS INTERNAL GOVERNANCE

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Abstract

Lawyers are increasingly part of executive decision-making reflecting the growing role of internal gatekeeping. We document that governance failures (frauds) occur less frequently after hiring general counsels into the executive suite. Perceived and caught frauds are 10% and 2.7% less likely to occur. We then hand-collect the career paths of executive general counsels to test how equity incentives given to gatekeepers causally impact governance and investment. Our identification comes from differences in reputational capital comparing lawyers hired from law firms and lawyers hired from positions in other corporations. In a matched difference-in-differences, we find that a one standard deviation increase in pay-for-performance sensitivity increases investment and acquisition intensity by 2.4% and 9.1% respectively. However, the same increase in equity incentives increases the likelihood of class action frauds by 13%, unwinding 66% of the gatekeeper role of improving governance. The evidence is consistent with the story that, when gatekeepers become executives, governance improvements may come at a shareholder cost in terms of risk appetite. Thus, boards use equity incentives to unwind the conservatism, but in the process, these equity incentives unwind the governance improvements of executive gatekeepers.

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I. Introduction

The corporate scandals of the early 2000s ushered in the Sarbanes Oxley regulatory reforms, pushing greater accountability and liability into the inner executive suite. As a result, governance and gatekeeping have crept further and further into everyday decision-making. One prominent aspect of the move toward internal gatekeeping is corporate attorneys moving up in the executive ranks. A case in point is Citigroup, which saw its leadership transition during the financial crisis to Charles Prince, III, an attorney rising from the ranks of corporate lawyer at U.S. Steel to Citigroup's Chairman and CEO. Other example is Gerson Zweifach, general counsel of News Corp, who left a three-decade job at a prestigious law firm with expertise in litigating media and First Amendment cases. Mr Zweifach's bonus and stock grants alone topped \$6 million for 2012. We use these examples to be provocative. The Citibank example is one of a corporate attorney becoming a non-gatekeeping, risk-taking executive. The News Corp. example is a case of highly incentivized gatekeeper in a complex organization needing specific legal expertise in the executive suite.

In this paper, we open the box of lawyers in the executive suite and speak to the equilibrium of bringing more gatekeeping to executive decision-making. Our contribution adds to the literature on the importance of characteristics of individuals inside the executive suite and board (e.g., Bertrand and Schoar, 2003; Malmendier and Tate, 2005). We present evidence that internal governance gatekeepers improve governance, as one might expect following the internal gatekeeping literature of Acharya, Myers, and Rajan, (2011); Kim and Lu (2012); and Khanna, Kim and Lu (2013) and the accounting literature of Kwak, Ro, and Suk (2012); Hopkins, Meydew, and Venkatachalam (2012); and Jagolinzer, Lacker, and Taylor. But our main contribution is about how gatekeeping and incentive compensation work together. Do performance pay equity incentives unwind the governance mandate implicit with appointing a general counsel as an executive? On the flip side, do equity incentives encourage gatekeepers to annul their gatekeeping or risk aversion biases in favor of investment and risk-taking in a valuation creation role for the firm?

We offer evidence that lawyers into the executive suite reduce governance failures, in particular, measures of fraud and expropriation. Of course, the elephant in the room is identification. Corporations hire lawyers into the executive suite for a reason, either because the company has entered or is entering a period of greater complexity or litigation risk (Choudhary,

Schloetzer, and Sturgess, 2012) or because the board has intent to improve governance. We match corporations hiring an ExecGC with companies on the litigation risk measure of Kim and Skinner (2012) within their industry-year. Our matched difference-in-differences estimation finds that corporations with an ExecGC experience 2.7% lower probability of conducting (AAER) accounting fraud. This is a large effect relative to the mean of 4.7%. We also find a 10% lower fraud score, an uncaught estimate of the probability the firm is committing fraud due to Dechow, Ge, Larson, and Sloan (2011). Both of these measures of fraud are capturing the arena where executive liability, and thus the role of internal gatekeeping, should be most active. We lay out why the bias in this specification is likely to be quite conservative. The caveat inhibiting us from using casual terminology in this part of the paper is that the board may have intent (and thus causation) to improve governance and use ExecGCs as the mechanism. Either way, our evidence finds that ExecGCs improve internal governance along several dimensions.²

The governance hiring results are only a baseline for our main agenda, which is to understand how equity incentives and governance interact. Most lawyers arriving in the executive suite have never before been exposed to performance incentives with payoffs tied to outcomes unrelated (or not closely related) to legal milestones. Our story is that the board may want risk-inducing equity incentives to encourage executive lawyers to be value-creators in their investment decisions, rather than simply to remain gatekeepers.³ However, if equity incentives do work to induce investment, we can study whether these incentives can at the same time unwind the governance improvements. Consider the career progression in Charles Prince's case, who clearly shifted his focus from attorney duties to corporate value-added. As the subprime crisis was hitting, Charles Prince is famous for saying, "As long as the music is playing, you've got to get up and dance," referring to Citigroup's continued issuance of subordinate debt entering into the Great Recession.

² Krishnan, Wen, Zhao (2011) look at the expertise of board member and find that accounting standards appear to be enforced with greater diligence when the board has a legal gatekeeper. In their language, having such a gatekeeper leads to "vigilance".

³ Having 'loose cannon' executives may be part of the value proposition of a firm, especially when firm value emerges primarily from intangible assets. These loose cannons may need governance checks; surely they do. But it is not clear from a real economy perspective whether corporations may have adapted too far to litigation and regulatory risks by mixing gatekeepers into the daily decision-process of those charged with taking risks via investments. One can easily argue from a career concerns point of view why such decisions might make sense for boards and executives. Equity incentives may be their tool to curtail conservatism in the executive offices when gatekeepers are involved.

The paper's main identification strategy relies on one simple argument; namely, that ExecGCs hired from law firms are initially unlikely to alter their behavior as a reaction to equity incentives. The logic is threefold: law firm lawyers (i) have their entire reputational capital built on their successful careers as lawyers, (ii) have the habit of being a lawyer, and (iii) are not yet skilled in value-creation. Under this intuition, ExecGCs hired from law firms seem a quite reasonable counterfactual (control group) for ExecGCs poached from other companies (the treatment group). The dimension that this setup leaves omitted is that the optimal contracting use of equity incentives varies in a way correlated with the selection of law firm versus corporate ExecGC as the hiring source. It is a bit difficult to come up with stories supporting this concern. Nevertheless, we address it by adding a third dimension in the matched difference-in-differences specification, by comparing against use of CEO equity incentives for the same corporations.

We collect extensive data on ExecGCs background, first sourcing from bios in corporate filings and then from online sources such as LinkedIn and law firm websites. These background careers allow us to set up matched difference-in-differences specification. We first look at investment outcomes, finding that a one standard deviation increase (\$49,600) in the sensitivity of general counsel pay to a one percent change in stock price increases investment and acquisition intensity by 2.4% and 9.1%, respectively. However, these same ExecGC equity incentives increase likelihood of class action frauds by 13%, unwinding 66% of the governance improvements from gatekeeping. For accounting scoring measures of uncaught frauds, the equity incentives increase fraud scores by 2%, unwinding 16% to 36% of the gatekeeping improvements. Overall, our results on equity incentives suggest that incentive contracts causally misalign the gatekeeping role of ExecGCs with investment. Whether these results imply overall value-destruction is unclear, since it may be that it is optimal from the shareholders' perspective to trade off some governance for productive investment.

The rest of the paper is organized as follows. Section two places our paper in the literature on gatekeeping, lawyers and governance. Section three sets out methodology and the research design. Section four describes data construction and sources. Section five discusses our empirical findings, with section six concluding the paper.

II. Literature

As an agent of shareholders, the responsibilities of general counsel have historically been first, to ensure that the firm remains in legal compliance with contracts and regulations and second, to assist the board in preventing corporate misconduct as an internal gatekeeper. (Appendix A describes these duties in detail, and Appendix B provides historical trends in the use of internal-versus-external legal expertise.) The rise of legal guardians into executive suite reflects an ever-increasing corporate need for legal expertise to manage complexities of regulation and litigation exposure. Yet by moving into the executive suite, general counsels also face the call to add value to the corporation more generally (Sorkin, 2012; Heineman, 2012). In some ways, daily operations in a world with intangible assets and growth options mandate that expertise in intellectual property rights be a part of the value-adding executive team. In our view, the fact that executive general counsel (ExecGCs) preside over duties both as the chief lawyer and as a member of the inner executive suite makes these individuals extraordinary; it also begs the question of whether these mandates conflict.

Our thoughts on gatekeepers in executive decisions build on the ideas of internal governance following Acharya, Myers, and Rajan, (2011), Kim and Lu (2012), and Khanna, Kim and Lu (2013), who study theoretically and empirically the possibility that agency problems between owners and managers can be at least partially alleviated with structures on internal governance. However, the topic of internal governance specifically through legal gatekeepers has received only sparse academic attention. In the legal literature, Demott (2012) describes these roles in a very instructive essay on how general counsel monitor, with case examples. We build on Demott's expertise and put out the question of whether her description of the actions that general counsel can take is empirically effective. The accounting literature is the first to consider lawyers and governance, focusing on the compliance aspect of general counsel's role. Kwak, Ro, and Suk (2012) find that so-called *super lawyers* serving as executive general counsels are found to enhance the frequency and accuracy of management earnings forecast, whereas Hopkins, Meydew, and Venkatachalam (2012) find the opposite. Further, Jagolinzer, Lacker, and Taylor (2011) show that the informed corporate insider trading can be mitigated by the requirement of general counsel's execution approval. Beyond this new field of inquiry in the accounting literature, little-to-no scientific evidence exists, on the effectiveness of general counsels in the executive suite, either in preventing governance breaches or in adding value.

Moreover, a noticeable fact is that the executive general counsels are granted equity incentives just like other non-gatekeeping executives. A natural question rise: How do gatekeepers respond to incentive pay? As Core, Guay and Larcker (2003) point out, a fundamental reason for the use of equity incentives is the desire by firms to link changes in executive wealth directly to changes in stock price, thereby providing executives with incentives to maximize shareholder wealth. In the capacity of general counsels in the executive suite, they maximize shareholder wealth through two channels: gatekeeping, and value creation through risk-taking. These two mandates interact with incentives in different ways. Brown, Harlow, and Starks (1996) and Chevalier and Ellison (1997) examine how managers change the riskiness of their activities in response to incentives and find that risk-taking is induced when managers' payoff is convex. Coles, Daniel, and Naveen (2006) document a strong positive relation between CEO equity incentives and riskiness of investment and leverage policies. Low (2009) show that in response to an exogenous shock that leads to risk-reduction, firms counter such adverse effects by providing managers with higher equity incentives. Following this evidence, we expect that equity incentives imposed on executive general counsels would induce risk-taking or counter their conservative bias of risk avoidance. On the other hand, there is mixed evidence on whether equity incentives enhance or hinder corporate governance. Core and Larcker (2002) document improved firm performance in a sample of firms that experience mandatory increases in executive stock ownership. Some hold the opposite view; examples are Goldman and Slezak (2006) and Efendi, Srivastava, and Swanson (2007), who argue that equity-based compensation is a double-edged sword, inducing managers to exert productive effort but also to divert valuable firm resources to opportunistic activities, such as misrepresenting financial statements. (A fuller list of literature can be found in footnotes 5&6 in Section III.b) In our setting, the gatekeeper role of executive general counsels adds yet another layer to the tension. We pose the question whether equity-based compensation is the right incentive to provide to these internal gatekeepers, and what kind of tradeoff it will introduce between the two mandates through which they create value for shareholders.

III. Methodology

III.a. Appointing an Executive General Counsel

Our empirical design uses the decision by corporations to hire an ExecGC. We focus on corporations hiring externally, since it is hard to know whether internal promotions are due to lawyering skills or other individual characteristics. The decision to hire an ExecGC is endogenous to firms' present and future needs. In particular, Choudhary, Schloetzer, and Sturges (2012) find that firms that are more complex, with higher litigation risk and stronger need for intellectual property knowledge are more likely to hire top tier corporate attorneys. Following this intuition, we pick three counterfactual matches for each hiring corporation from the non-hiring corporations within the industry-year prior to the hiring, restricting observations to those filled in Compustat and ExecuComp two years on each side around the event. Specifically, the matches within the industry-year are those closest in the litigation measure of Kim and Skinner (2012).⁴

Our matched difference-in-differences specification, with fixed effects denoted by μ , is given by:

$$y_{it} = \alpha_0 + \alpha_1 Post_{it} + \alpha_2 Treat_{it} + \alpha_3 Post_{it}Treat_{it} + \mu_{time} + \mu_{industry} + \mu_{time}\mu_{industry} + \mu_{hireyear} + \varepsilon_{it} \quad (1)$$

where $\begin{cases} treated = corporation\ with\ ExecGC\ hired\ at\ date\ h \\ untreated = corporation\ matched\ at\ (h - 1)\ with\ no\ ExecGC\ hired\ in\ window. \end{cases}$

Governance failures are denoted by y , with indices i and t denoting corporation and year respectively. $Post$ is an indicator for being after the hiring of the ExecGC, or of the matched ExecGC for the control. We toss out the year of hiring, to allow for the transition. Included are fixed effects for year, hire year, industry (at the two-digit SIC code level), and (single digit) industry-crossed with year. We weight the nearest neighbor matches to add up to unity and cluster observations at the corporation-hire level. The difference-in-differences estimator of interest is α_3 , which captures the sensitivity of governance to having an ExecGC.

The conditional mean independence assumption is that in the absence of hiring an ExecGC, the firm's governance would have evolved as other firms in the same industry in the same year with similar litigation. To discuss the validity of this assumption, it is worth stating that this test is one-sided in the sense that our design is presumably looking for governance improvements. As such, the specification should bias against us with the following logic. The dimension not incorporated in the empirical design is the extent to which the hiring of an

⁴ See Appendix Table 2 for coefficients of estimates of replicating Kim and Skinner (2012) litigation risk model using Compustat firms in our sample period.

ExecGC reflects future needs for gatekeeping. However, the selection of corporations' hiring ExecGCs should correlate with those desiring to mitigate a future strain on governance. Said the other way, the counterfactual of similar-looking corporations choosing not to hire an ExecGC should be those not facing the same need for gatekeeping in the future. Thus, any improvement in governance we find at the hiring of an ExecGC would have to come over and above the relative decline from the strain endogenously causing the hire.

There is a plausible alternative story. Corporations may hire ExecGCs with the intent to improve governance irrespective of future needs for gatekeeping. In this alternative, the causation for governance improvements should fall on the board or existing management. Nevertheless, the mechanism is the ExecGC. To be conservative, we limit our interpretation of these baseline results to this mechanism story. We also test for other mechanisms at work at the time of hiring.

In a second set of specifications, we look at y outcomes of investment and risk-taking rather than governance failures. The goal of such a specification would be to ask whether putting a gatekeeper in the executive suite dampens the appetite for productive risk, as measured by future investment. We use exactly the same matched difference-in-differences setup, except that we include the controls for risk-taking at t , and our outcome measures y are measured at $t+1$, following Cassell et al (2012). The one-sided hypothesis would be that if a gatekeeper hinders investment and risk-taking, we would expect to see a negative relation between investment or risk-taking variables and the *Post*Treat* dummy. This specification, however, does not pass the "sniff test" of the selection being conservatively biased. Corporations choosing to hire ExecGCs, as compared to other firms matched in industry-year and litigation, are likely to be entering more aggressive phase of the business, potentially with new investment or acquisition plans. We do not have an identification strategy around this bias. Thus, we simply present these investment results as a pre-cursor to the equity incentive results on investments.

III.b. Equity incentives

Our main question is whether equity incentives align executive gatekeeping with governance and investment. A word is in order as to how these outcomes fit into the mixed evidence in the literature on whether equity incentives align managers in general with shareholder value. Many papers find that equity incentives associate with higher firm valuation and performance, supporting an incentive alignment view of equity incentives and agency

models.⁵ However, others find that equity incentives induce managers to manipulate earnings, misreport financial statements, rig the performance measure chosen, conduct fraud, and opportunistically time option grants.⁶ The tension is whether equity incentives induce short-term goals of managers because of agency and information issues in implementing optimal contracting.

The question as to whether equity incentives work for ExecGCs relies on a second dimension. Are equity incentives the correct alignment for a gatekeeper in particular? The governance literature (e.g., Shleifer and Vishny (1998), Gompers, Ishii, and Metrick (2003)) finds that well-governed firms command higher valuations. But it is an unexplored question as to whether the governance-to-value relation is achievable through equity incentives.

Our story is that executives have a growing fear of personal liability. They may seek out internal gatekeepers to protect themselves. But gatekeepers may need equity incentive encouragement to induce support for investment and productive risk-taking.⁷ The question is whether this unwinds the governance improvements. We look to the value-creation components of governance and investment/risk-taking outcomes to assess the evidence for these pieces.

Our main empirical strategy relies on identification arguments concerning the type of organization from which the new ExecGC is hired. Figure 1 shows that external hires are hired predominantly from two sources – law firms and other companies. Corporations hire law firm lawyers because of their skill as lawyers, since the law firm lawyer often does not have experience adding corporate value.⁸ Conversely, corporations poach ExecGCs from other companies because of the lawyer’s reputation both as a lawyer and value creator.

Our identification argument is that because a lawyer hired from law firms has built his or her reputation, human capital, and habit solely as a lawyer, the impact of equity incentives is

⁵ Demsetz and Lehn (1985), McConnell and Servas (1990), Core and Guay (1999), Guay (1999), Himmelberg, Hubbard, and Palia (1999), Core and Larcker (2002), Goyal and Wang (2012), for example.

⁶ See Cheng and Warfield (2005) and Bergstresser and Philippon (2006) on earnings management, Goldman and Slezak (2006) and Efendi, Srivastava, and Swanson (2007) on accounting misreporting, Morse, Nanda, and Seru (2011) on rigging incentive contracts, Denis, Hanouna, and Sarin (2006) and Erickson, Hanlon, and Maydew (2006) on accounting fraud, and Aboody and Kasznik (2000) on opportunistic option grant, for example.

⁷ The literature uses the concept of risk-taking in both good and bad contexts. The traditional idea is that the risk-taking (investment) is the essences of a corporation (Jensen, 2000). However, excess risk-taking may reflect a short-term reaction to equity-incentives. Evidence in Gormley, Matsa, and Milbourn (2012), Hayes, Lemmon and Qiu (2012), and Shue and Townsend (2013) suggests that equity incentives may induce more risk-taking by executives.

⁸ To the extent that this person has already been working with the firm in a legal capacity, which is likely, the lawyer may already interact frequently with the other executives. However, given the per-hour billing for legal expertise, these interactions would be generally limited to discussions of situations requiring legal oversight.

unlikely (or less likely) to alter gatekeeping behavior *initially*. For law firm partners, depletion of legal reputation capital (their only capital) is extremely costly, and they are not conditioned either to be value-creators or to stray from strict practices that characterized their successful law firm careers. Lawyers hired from counsel positions in other companies are on average more likely to incorporate the multitask of being a lawyer and a value creator.

We assign the ExecGCs hired from other corporations as the treatment group and lawyers hired from law firms as the control group. Thus our design sets up a counterfactual to handle the choice of hiring, while allowing for equity incentives to differentially work differently between the treatment and control. As before, we match hired ExecGCs within the year and one-digit SIC industry divide on litigation risk. We denote X^{GC} as the level of equity incentives for the ExecGC, measurable only in the post period. In practice, we use the sensitivity of ExecGC compensation to the stock price (the “delta”) measured at the end of the excluded hire year as the measure to avoid confounding performance. The estimating equation is:

$$y_{it \text{ or } t+1} = \alpha_0 + \alpha_1 Post_{it} + \alpha_2 Treat_{it} + \alpha_3 Post_{it}Treat_{it} + \alpha_4 Post_{it}X_{i,hireyear}^{GC} + \alpha_5 Post_{it}Treat_{it}X_{i,hireyear}^{GC} + \mu_{time} + \mu_{industry} + \mu_{time}\mu_{industry} + \mu_{hireyear} + \varepsilon_{it}. \quad (2)$$

where $\begin{cases} Corp = corporation \text{ with ExecGC hired from corporations at date } h \\ Law = corporation \text{ with ExecGC hired from law firms at date } h, \text{ matched at } (h-1). \end{cases}$

As before, when the y variable is investment, as opposed to governance, we use the $t+1$ outcome and we include standard control variables used in the analysis on corporate risk taking.

Contract theory predicts that firms with different contracting environment vary in optimal incentive levels. Studies on executive compensation (e.g. Core, Holthausen and Larcker (1999), Armstrong, Jagolinzer, and Larcker (2010)) suggest that both innate firm economic characteristics such as size, complexity and growth, and firm corporate governance characteristics affect managerial compensation. A possible endogeneity concern is that the corporation’s selection of poaching a general counsel from another company versus hiring from a law firm may reflect some omitted variable correlated with the effectiveness of equity incentives.

We take two additional steps to isolate the effect of ExecGC equity contracts after removing the cross-sectional and time series optimal contracting by the firm.⁹ We first introduce the equity incentives of the CEO into the specification:

$$y_{it \text{ or } t+1} = \alpha_0 + \alpha_1 Post_{it} + \alpha_2 Treat_{it} + \alpha_3 Post_{it} Treat_{it} + \alpha_4 Post_{it} X_{i,hireyear}^{GC} + \alpha_5 Post_{it} Treat_{it} X_{i,hireyear}^{GC} + \alpha_6 Post X_{i,hireyear}^{CEO} + \alpha_7 Post Treat_{it} X_{i,hireyear}^{CEO} + \mu_{time} + \mu_{industry} + \mu_{time} \mu_{industry} + \mu_{hireyear} + \varepsilon_{it}. \quad (3)$$

where $\begin{cases} Corp = \text{corporation with ExecGC hired from corporations at date } h \\ Law = \text{corporation with ExecGC hired from law firms at date } h, \text{ matched at } (h-1). \end{cases}$

The idea is a form of a triple difference. We isolate the sensitivity of investment and governance to ExecGC equity incentives by comparing (i) over time, (ii) against outcomes when similar equity incentives are granted to ExecGCs hired from law firms, and (iii) against outcomes once the effect of equity incentives granted to CEOs are removed.

A final specification, in the same spirit of the above, matches ExecGCs hired from companies with those hired from law firms on the level of bonus-to-salary (split high-low), in addition to the year and one-digit SIC industry divide and litigation risk. The idea here is that the salary-to-bonus level at the hire year is a measure of the importance of incentive pay for the corporation in hiring the ExecGC. We choose bonus as the measure since it should not be correlated with future stock performance.

IV. Data & Statistics

IV.a. Sample and General Counsel (GC) Data

We impose two attributes to designate ExecGCs : (i) the individual must hold a title reflecting such status (generally “general counsel”, “chief legal officer”, or some similar iteration) and (ii) the individual is among the top paid officers in a company. The second dimension is not innocuous for a definition of a general counsel being in the executive suite. Rather, admittedly, it is a monetary proxy as a measure of the importance of the general counsel. In our empirical design, we force stringency that this proxy importance is not transitory in requiring that the officer remain in the top paid executives for the full three year post period.

Our data collection begins with the ExecuComp sample, covering the period 1995-2012 and encompassing 32,610 annual firm level observations of more than 3,000 unique firms In

⁹ We are also in the process of collecting data on distance from the corporate law firm to instrument for the potential time that that corporation’s external counsel spends in the firm.

ExecuComp, we identify individuals holding the requisite titles searching three key words: “Counsel,” “Legal,” and “Law” or abbreviations thereof.¹⁰ To address any shortcomings in the ExecuComp title information, we further identify general counsels through manually recording the signatures of the legal representative in 10-K filings (items 4b and 10) and proxy statements.¹¹ For all general counsels, we take the final step to determine if the general counsel qualified by our monetary proxy measuring of being an ExecGC.

For ExecGCs in the sample, we identify their age, gender, full executive title, tenure, the year when they joined the company, whether they are on the board of directors, whether they are corporate secretary, and a full spectrum of their work experiences from law school graduation to prior to becoming ExecGC of a firm. For all past work experiences, we collect information on the names of prior employers, whether the prior employer is a law firm, the job title at the firm, and the duration of the employment. In ExecuComp itself, we collect a range of compensation items for the ExecGCs and CEOs. We calculate the value of option grants using the Black-Scholes model.¹² Total pay is defined as the sum of salary, bonus, other cash compensation, restricted stock grants and option grants. Then, we follow Core and Guay (2002) to estimate the sensitivity of the value of the ExecGC’s accumulated equity- based compensation (including both stocks and unexercised options) to a one-percent change in the stock price, which is referred to as “delta”.¹³

¹⁰ ExecuComp often records the abbreviation of an executive title. For example, the title of a GC could be spelled as “gen cou,” “gncns,” “gen cns,” etc. We add all versions of these words we can find. Further, the initial search of the three key words resulted in many executives who are not GC (e.g. “Special Counsel”, “Former Counsel”). We verify whether the executive officer identified is in fact a general counsel of the firm through further reading their full executive titles.

¹¹ If a firm is found to have no general counsel in our sample, there are two possibilities: either that the firm does not have a general counsel or that the position of general counsel is not important enough to make to the list of corporate officers in 10-K and/or def14a filings.

¹² We follow Core and Guay (2002) with minor modifications to estimate the grant date value of options. First, if the grant date is missing, it is assumed to be June 30 of that year. Option maturity is assumed to be seven years if the maturity date is missing. Second, the expected stock return volatility is measured as the annualized standard deviation of daily stock returns over the fiscal year in which the grant was made. A firm must have 50 observations for its volatility to be estimated, or else we use the median of the volatility distribution of all firms in ExecuComp in a given year. Following the practice of ExecuComp, we replace the volatility with its 5th and 95th percentile, respectively, if it is either below the 5th percentile or above the 95th percentile of all observations in a given year. Third, expected dividend yield is the ratio of cash dividends paid in the fiscal year of the grant and the fiscal year-end stock price. Finally, the Treasury bond yield corresponding to the option's expected time to maturity is used as the risk-free rate.

¹³ In order to calculate delta, we require information on the number of shares and both the number and value of unexercised options held by the ExecGC. We find that ExecuComp often does not report the actual share ownership for non-CEO executives. In such cases, we assume the delta of stock holdings to be zero. Nevertheless, for

IV.b. Governance Outcome and Investment / Risk-taking Measures

We measure governance outcome in five dimensions: class action suit class periods, option grants backdating, ex-ante probabilities of accounting fraud and earnings manipulation, and conviction of accounting fraud.

Class actions suits occur when shareholder value is destroyed because of all types of misconduct in violations of securities law. (See Dyck, Morse and Zingales (2010) or Karpoff (2013) for a comparison of fraud data.) To construct a fraud class action variable, we collect all securities class action lawsuits filed during 1995-2012 from the Stanford Law School Securities Class Action Clearing house and merge them to Compustat.¹⁴ There are altogether 1,187 lawsuits filed during this period with 582 cases that were dismissed by the court, which are removed from the sample. Our measure of governance failure is an indicator (*Class Action*) that takes the value of one if the firm fiscal year coincides with the class period, and zero otherwise.

The next indicator of governance failure is backdating. Prior studies (Lie, 2005; Heron and Lie, 2007; Bizjak, Lemmon, and Whitby, 2009; Wu, 2012) consistently document a V-shaped return pattern around firms' option grant dates as evidence of engagement in option backdating, i.e., firms use hindsight to pick a date when the stock price is particularly low and claim that executive options were granted on that low-price day. Following these papers, we retrieve option grant dates from Thomson Financial (TFN), calculate the return reversal twenty days before and twenty days after the grant date, and use the abnormally high return reversal (i.e., if reversal deflated by stock return volatility is greater than the 75 percentile of all TFN firms) as indicator of engagement in backdating.

The uncaught likelihood of accounting fraud is captured by *Fraud Score*, which is calculated using the misstatement prediction model and coefficient estimates of Dechow, Ge, Larson, and Sloan (2011). (A full list of inputs and the formula can be found in Appendix Table 1.) Earnings manipulation is captured by *Manipulation Score* (Beneish, 1999), which employs eight financial ratios, such as gross margin, sales growth, and depreciation, to detect earnings

robustness purpose, we perform additional multivariate tests by using the sub-sample after dropping delta that carries zero values.

¹⁴ The Stanford Law School Securities Class Action Clearing house database was employed by a number of prior studies on measuring litigation risks (e.g., Field, Lowry, and Shu (2005), Dyck, Morse, and Zingales (2010), Hanley and Hoberg (2012), and Kim and Skinner (2012)).

manipulation. (A full list of inputs and the formula can be found in Appendix Table 1.) Both scores indicate the likelihood of uncaught earnings manipulation and fraud.

The final measure is Accounting and Auditing Enforcement Releases (AAERs), accounting frauds caught by SEC. These data are from the Center for Financial Reporting and Management Center at the Haas School of Business, UC Berkeley. AAERs are issued by the SEC during or at the conclusion of an investigation against a company, an auditor, or an officer for alleged accounting and/or auditing misconduct.¹⁵

Turning to investment and risk-taking, our first measure is annualized equity volatility based on daily returns over a fiscal year, reflecting the ideas of excess risk-taking in, for example, Shue and Townsend (2013). Second, we use R&D expenses deflated by assets as a proxy for investment intensity in intangible assets.¹⁶ The third measure is acquisition scaled by assets; and the last measure we adopt is investment intensity as in Eisdorfer (2008), which is defined as the ratio of capital expenditure to PP&E. To construct these measures, we obtain firm-level financial data from Compustat, and the stock return and trading volume data from CRSP.

IV.c. Litigation Risk Measure and Other Governance Variables

We follow Kim and Skinner (2012) to construct an *ex ante* litigation risk measure for all sample firm years. Kim and Skinner identify industry (such as membership in the biotechnology, computers, electronics, and retail industries), size, sales growth, stock returns, return volatility, skewness, and liquidity as among the most important factors in determining firm litigation risks. We build determinant variables identical to Kim and Skinner and perform a logit regression for all Compustat/CRSP firms during 1995-2012 with dependent variable equal to one if a firm is sued in a given year. Prob_sued is calculated based on the coefficient estimates of this logit regression. Appendix Table 2 reports coefficients of estimates from this estimation.

¹⁵ Using AAERs as a sample of misstatement firms has several advantages relative to other potential data sources. First, the use of AAERs as a proxy for manipulation avoids potential biases induced in samples based on researchers' individual classification schemes, and can be easily replicated by other researchers. Second, 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. AAERs have been used in accounting literature in studying accounting misstatements and frauds (e.g., Dechow, Ge, Larson, and Sloan (2011)).

¹⁶ Koh and Reeb (2014) found that firms reporting no information about R&D actually file more patents than firms reporting zero R&D, suggesting that the non-reporting firms may have made non-trivial investment but opted to classify R&D expenditures into other expenses, putting into question the practice of treating missing R&D as zero. We therefore replace missing R&D with industry median based on 2-digit SICs.

Finally, our analysis will consider six typical measures on corporate governance that characterize internal and external monitoring to address the concern that involvement in governance outcomes may be due to other mechanism of governance rather than the hiring an ExecGC. First, we collect quarterly institutional ownership from 13F filings through Thomson Reuters Ownership Database. We use percentage of stocks held by all institutional investors from filings of the last quarter of the previous fiscal year as our measures of institutional ownership. Further, we calculate the Herfindahl-Hirschman Index (HHI) of percentage stock holdings by institutional investors, and identify the existence of a blockholder to proxy for external governance. Second, we obtain board size and board independence to capture the strength of board governance. Finally, we obtain G-index as developed by Gompers, Ishii and Metrick (2003) from Riskmetrics to proxy for the level of shareholder rights.

IV.e. Statistics

Table 1 profiles ExecGCs' presence in the top management team and their characteristics on an annual basis. Statistics of this table are based on our full sample of 32,610 firm-year observations and tabulated by fiscal years. A few statistics are of particular interest. The first column, labelled ExecGC, reports the percentage of firms' having an ExecGC by year. There is a secular trend on having an ExecGC in a corporation. In the year 1995, 33% of the S&P 1500 firms have an ExecGC; the percentage increases to 44% as of year 2012. Conditional on having an ExecGC, the remaining statistics report that ExecGC compensation has increased as a fraction of CEO pay from 34% to 43%, while the percentage of equity ownership remained relatively stable, declining slightly from about 0.3% to 0.2%. Given that CEO equity ownership experienced an even larger decline over this time period, GC equity ownership as a fraction of CEO ownership actually increased. ExecGC Delta over the sample (at \$50,000) is about one-tenth of CEO Delta.

For all ExecGCs in our sample, Figure 1 depicts their full career paths prior to becoming ExecGC. The immediate hiring sources fall in four categories: internally promoted, externally hired from other corporations, externally hired from law firms, or externally hired from government. Less than 30% of the ExecGCs in our sample are promoted internally. Law firm hires (29%) and corporation hires (41%) account for the majority of career paths into the job. Appendix Table 3 lists the top 20 (AM Law 100) law firms that produce the most law firm hires

in our sample. What was a bit of a surprise to us is the breadth of law firms. Almost all the top 100 firms have representation in our sample.

Our main analyses employ a difference-in-differences approach that examines the changes in governance/risk-taking prior to and after the hiring of an ExecGC, compared to a counterfactual (i.e., no-GC firms in the baseline, and law-firm hired ExecGCs in the equity incentive analyses). Consistent with such design, Table 2 provides summary statistics reported for the fiscal year in which ExecGC is hired, with ExecGC/no-ExecGC split as well as hiring sources split. For each group, the table presents the mean of ExecGC and CEO compensation, firm characteristics, governance outcome, risk-taking variables and other governance measures.

The firm-level summary statistics show that firms facing higher litigation risks tend to hire an ExecGC, and that larger firms with more rapid growth tend to hire ExecGC from law firms. Governance in some dimensions, e.g., as indicated by fraud score and AAER fraud, seem to be weaker in the group of external hires than internal hires, suggesting that the source of hiring is likely associated with need for governance improvement, which corroborates the rationale for our identification strategy based on hiring sources. Further, firms that hire ExecGCs externally tend to face higher investment risks at the time hiring, reflecting the current need for ExecGCs. Other governance measures suggest that the sources of hiring are unlikely affected by the corporate governance quality at the time of hiring.

V. Results

V.a. Baseline Results on Governance

Table 3 presents the univariate tests on the evolution of governance failures (in Panel A), and non-legal components of corporate governance (in Panel C) around the hiring of ExecGCs, dropping the hire year. (We discuss the investment results in this table in the next subsection.) We present these tests by hiring source and also for the broader non-hiring firms. Finally, we perform difference-in-difference tests, comparing firms with externally hired ExecGCs with firms with no ExecGCs.

Working downwards in the table, we find that the counterfactual no-ExecGC firms see significant increase in the incidence of class action suits. ExecGC-hiring firms, however, do not see a rise in class action suits after ExecGC hiring. The difference-in-difference test shows that

firms with externally hired ExecGCs, compared to the no-ExecGC firms, have significantly lower probability of a class action suit, with a magnitude of 0.0112, which represent 20% of the pre-treatment (pre-hiring) mean likelihood of class action lawsuits for treated companies.

The backdating sample is smaller, since the practice essentially stopped after the vast media attention in 2007. In this instance, we find the opposite result that the counterfactual no-ExecGC experienced an improvement in backdating. (Later, the inclusion for time controls negates this finding.)

For the remaining three governance failure variables, we find evidence of improved governance in ExecGC-hiring firms. The accounting manipulation scores and fraud scores significantly decrease after ExecGCs, across all sources of hiring with firms that hire ExecGC externally experiencing the most reduction. The counterfactual no-ExecGC group also experiences improved scores but with a smaller magnitude. As seen in the difference-in-difference test, the external hire group experiences 0.1155 more fraud scores reduction and 0.1063 more manipulation scores reduction, which represent 9% and 4% of the respective mean. Further, firms that hire ExecGC, especially those hired externally, tend to experience a decline in the likelihood of caught fraud while the no-ExecGC firms see no change over the six-year period. Put it into perspective, the external hire group reduces AAER fraud by 0.0175 (37%) more than the no-ExecGC group.

In the introduction and methodology, we are careful to say that the mechanisms of governance effects may be the ExecGC, but we cannot attribute causal intent to the ExecGC necessarily in the case that the board may be implementing an agenda through the ExecGC mechanism. In Table 3, panel C, we can reinforce that the mechanism is the lawyer. In this panel, we look at other, non-legal governance improvement mechanisms around the hire date of the ExecGC. We find that firms that hire ExecGCs from each of the three different sources exhibit almost identical patterns of governance changes across these other six, non-legal metrics of corporate governance, with the possible exception of board size. All firms, regardless of whether they hire ExecGCs or not, experience an increase in institutional ownership and the frequent presence of a blockholder. All three groups of firms that hire ExecGCs have more independent boards and higher governance index after the hiring, likely reflecting the impact of SOX and related regulatory changes. We do not see evidence of future need fulfilled through other governance channels, though of course we cannot fully rule out such possibility.

Table 4 extends the univariate difference-in-differences results of Table 3 by including hire year fixed effects, calendar year fixed effects, year and one-digit industry interacted fixed effects, and two-digit SIC industry fixed effects, to control for unobservable omitted business cycle and industry characteristics that may have an impact on the evolution of governance outcomes in the panel. The dependent variables are five governance failures. *Post* is an indicator variable taking on the value of one for the three years after ExecGC hiring. We are primarily focused on the coefficient on the interaction term *Treated*Post*, which captures the sensitivity of governance failures to having an ExecGC. Standard errors are clustered at the firm level for all regressions.

Our results in Table 4 show that corporations that hire an ExecGC experience a reduction in the fraud score of 0.129. With *Fraud Score* having a pre-treatment mean of 1.28 (Table 3), this coefficient means that the perceived likelihood of the corporation committing fraud is 10 % lower. We also find that governance improves with an ExecGC by lowering the incidence of AAER fraud by 2.7%, which is a small percentage number but a very large effect relative to the pre-period mean of 4.7%, representing 57% reduction.¹⁷ We are unable to identify a significant effect in our stringent specification for the other measures.

V.b. Baseline Results on Investment and Risk-Taking

We turn to investment and risk-taking, beginning with panel B of Table 3. The dependent variables capture investment in tangible assets (investment intensity), intangible assets (R&D), or risky investments in general (acquisition), and potentially excess risk-taking as measured by volatility of stock returns. We find no difference in the treatment effect (external hires) relative to the control of no hires for any of the investment or risk-taking measures. Our strong prior was that firms that hire ExecGCs are ones entering a risk-taking phase. Finding that no such pattern exists in the difference-in-differences test suggest that the lawyer ExecGCs may be hindering risk-taking, but our evidence is only consistent with such a story.

Table 5 extends the baseline investment analysis to the full specification as in Table 4. Following Cassell et al (2012), we also control for log assets, log sales, leverage, cash holdings, sales growth, market-to-book, annual stock return, and log age of the firm and measure the

¹⁷ In Dyck, Morse, and Zingales (2013), caught frauds are only 27% of committing frauds, thus the importance on the magnitude of both of these variables.

dependent variable at $t+1$. We expect to see an inverse relation between corporate investment and risk-taking variables and the *Post*Treat* dummy. However, as in the univariate results in Table 3, the interaction term is statistically insignificant in all columns of Table 5. The weak evidence confirms our concern that the selection of corporations choosing to hire an ExecGC would bias against us, as they are more likely to be entering more aggressive phase of the business compared to the non-hiring firms. The actual treatment effect would likely be cancelled out by the direction of selection reflected in the need for hiring an ExecGC.

V.c. Incentive Contract Results on Investment and Risk-taking

In the prior section, we do not interpret any causal effect from the investment outcomes around hires. In this section, however, we can use our identifying assumption to identify a plausibly causal effect of equity incentives on the gatekeeper-risk taking relationship. Table 6 reports our results as to whether equity incentives induce investment and risk-taking goals for a gatekeeper. The treated corporations in the tests are firms hiring an ExecGC from a corporation against the control of hiring an ExecGC from a law firm matched on litigation within the industry-year. We present these results in three panels. Panel A shows our baseline OLS estimates, where the 2-digit SIC industry effects are not included. Our sample reduces to 357 corporations in these tests, and it is this not innocuous to have so many fixed effects. We introduce for 2-digit SIC industry effects in panel B. Panel C adds another dimension on which we sort companies prior to the matching. In particular, to further isolate the effect of optimal contracting, we split ExecGCs at hireyear into those with high or low bonus-to-salary ratios. We then draw match firms within the industry-year and bonus split to the treatment sample. Because the pools are small, this essentially drops treatments for which no commonly support controls are available and assigns weights differently.

Our main independent variable of interest is the hire year delta, the wealth sensitivity of the executive to firm equity performance. We focus on the hire-year observation, and thus forcing a reliance on sign-on incentive contracts, to avoid an endogenous variable. We run four independent models for each investment or risk-taking outcome variable used in the three panels of Table 6. The first model reports the simple difference-in-difference of the treatment effect on governance. The second model adds two interactions terms on ExecGC's delta, *Post*GCDelta_Hireyear* and *Post*Treat*GCDelta_Hireyear*. The first interaction variable

measures how the ExecGC's delta in the control firms is related to investment outcomes, and the second interaction variable, which we are in particular interested, measures whether the equity incentives affect investment and risk-taking differently for the treated and control groups. The third model further controls for two interaction terms on CEO delta at the year of ExecGC hiring to remove the potential effects of equity incentives granted to the CEO on governance outcomes. Finally, the fourth model removes equity incentives granted to ExecGC while maintaining the two interaction terms on CEO delta. The purpose of this test is to examine whether equity incentives granted to the CEO affects outcomes differently between firms that hire ExecGCs from corporations versus those that hire ExecGCs from law firms.

Across our four risk-taking measures in Table 6 – investment and acquisition intensities, R&D-to-assets, and equity volatility – we find that equity incentives induce greater investment intensity and acquisition consistently in all three panels. The coefficient on *Treat*ExecGC_Delta_Hireyear* is strongly positive and significant. We find some limited support for the role of equity incentives on R&D as well (in panel B), but only weakly so. Note that we did not set these tests up to be one-sided. It may well have been that equity incentives given to the gatekeeper could have induced a reduction in risk-taking if the gatekeeper deemed it unproductive. Along this thinking of excess risk-taking, we find no relation between gatekeeper equity incentives and equity volatility.

In our methodology, we stated a concern that the selection of law firm hire versus company poach might be correlated with the optimal contracting effectiveness of equity incentives on risk-taking. The coefficients on our main variable do not diminish materially (and sometimes increase) when we control for the triple difference of the CEO delta at hire year. Panel C suggest some role for this selection, as our statistical and economic significance on investment intensity diminishes somewhat, but our results remain robust.

In terms of the magnitude, we focus a one standard deviation higher value of the ExecGC in the cross section, or \$49,600 (0.0496 in the scaling of the table). A \$49,600 larger ExecGC delta translates into an increase in the independent variable (*Treat*ExecGC_Delta_Hireyear*) equivalent of 0.00565, because of the bulk of zeros from the interaction terms *Post* and *Treat*. (Alternatively, a one standard deviation increase in this independent variable is more than two-times larger, but we did not think this was a fair magnitude statistic to present.)

Using the coefficients from panel C of Table 6 (columns (3) and (11)), this one standard deviation increase in delta translates to an increase of 2.4% of a standard deviation in investment intensity and 9.1% in acquisition intensity. Assuming normality, these increases are large in distribution-space.

V.e. Equity Incentives Results on Governance

Our story throughout has been that lawyers are brought into the executive suite to gate-keep in an era of added importance of intellectual property and in an era of increased executive liability. To induce risk-taking (or to counter conservatism in investment) by naturally conservative agents, boards may offer these executives equity incentives. As we have just seen, equity incentives indeed impact risk-taking by gatekeepers. Gatekeepers respond as rational agents. Finally, we now turn to the question of whether these same equity incentives unwind governance improvements.

Table 7 reports our results as to whether equity incentives align or misalign gatekeeping roles, where treated corporations in the tests are firms hiring an ExecGC from a corporation against the control of hiring an ExecGC from a law firm matched on litigation within the industry-year. The setup is identical to that of Table 7. Recalling that our identification assumption is that ExecGCs hired from law firms are unlikely to change gatekeeping practices because of equity incentives at least in the short term, we interpret the coefficient on *Post*Treat*GCDelta_Hireyear* as causally identifying the impact of equity incentives on the gatekeeper-governance relationship.

We find evidence that equity incentives erode the governance improvements in four dimensions – class action fraud, option backdating, and the two measures on “uncaught” accounting manipulation and fraud scores. Across all three panels, we consistently, with a couple of exceptions, find positive significant coefficients on *Post*Treat*GCDelta_Hireyear* for each of these dependent variables. If anything, panel B is the weakest effect not surprisingly, which incorporates the 2-digit SIC fixed effects (in addition to the one-digit SIC effects interacted with year).

Again, we need to address the omitted dimension of the selection of law firm hire versus company poach being correlated with the optimal contracting effectiveness of equity incentives. In governance outcomes, this concern seems not at all borne out in the data. The coefficients on

our main variable do not diminish materially (and sometimes increase) when we control for the triple difference of the CEO delta at hire year. In addition, panel C, which matches law firm and poached ExecGCs on their bonus levels does not lose statistical and economic significance.

As in the investment and risk-taking results section, we want to put these coefficients in perspective relative to a one standard deviation larger ExecGC delta (an increase in delta of \$49,600), which translates into a change in the independent variable of 0.005652. When we consider the coefficients (Columns (3) and (7)) in panel C of Table 7, we find that a \$49,600 larger delta, translates to an increase in the probability of class actions fraud and backdating of 0.0074 (0.00565×1.313) and 0.0410 (0.00565×7.249), respectively. Put into perspective, these numbers represent 13.53% ($0.0074/0.0547$) increase in fraud and 12.51% ($0.0410/0.3277$) increase in backdating.

In terms of the score variables (fraud score and manipulation score), the baseline scoring scale has no natural interpretation. Thus, we interpret relative to one standard deviation in the score. Using the same \$49,600 increase in the ExecGC delta, we find our estimates in Columns (11) and (15) suggest that a one standard deviation increase in delta increase the perceived probability of accounting fraud and manipulation by 1.46% of a standard deviation and 1.59% of a standard deviation, respectively. These are much smaller magnitudes.¹⁸

In sum, our evidence supports the story that equity incentives indeed align potentially productive investment incentives, but unwind governance improvements. We provide in Table 8 the magnitude of unwind as a percentage of governance improvement, using the univariate results of Table 3. Economic magnitudes at first pass seem reasonable and meaningful. ExecGCs are associated with a 20% reduction in class action lawsuits, yet one standard deviation larger delta increases the incidence of such lawsuits by 14%; in other words, one standard deviation of delta increase unwind 66% ($14\%/20\%$) of governance improvement. Similarly, the unwind in fraud score and manipulation score is 16% and 36% respectively.

VI. Conclusion

Internal governance has grown in popularity among executives, as they have increasingly become personally exposed to regulation and punishment for misconduct. We build on new

¹⁸ In the next draft, we will give some examples here of firms and their manipulation scores to get a feel for what this magnitude means in practice. The mean of these scores are not meaningful constructs, so we just interpret relative to the distribution (standard deviation) in the scores. But there are outliers in the scores, which means these are large standard deviations to which we are comparing.

research emerging in the accounting field that considers this growing form of internal governance; namely having the legal gatekeepers in the executive decision process. We provide evidence that executive general counsels improve governance, reducing the probability of fraud in multiple dimensions.

From this baseline, however, our main insights concern equity incentives and risk-taking. In our tests, equity incentives are misaligned with governance outcomes, unwinding much of the improvement in governance associated with having an internal gatekeeper. These results draw into question whether the catch-all governance term and all the value-creation results associated with it should be applied quite so broadly. Governance is robustly found to be value-creating in the literature, but perhaps gatekeepers cannot be aligned with the short term nature of valuation incentives.

Equity incentives unwind governance improvements but also encourage investments. We cannot identify whether these gatekeepers themselves hinder investment, but it is easy to tell a story of conservatism consistent with what we find. Executives may desire to protect their careers by gatekeeping themselves rather than optimizing risk-taking. Under this notion, internal gatekeepers themselves are potentially an agency concern for shareholders, resonating of Jensen's free cash flow arguments. Proving or dis-proving this story is left for another day.

Finally, we open the box a bit more in the attributes of executives. We know that executives and board members can have their own fixed effect (Bertrand and Schoar, 2003; Malmendier and Tate, 2005). In addition, much has been said about financial expertise inside the firm (particularly on the board) (Güner, Malmendier and Tate, 2008). We introduce legal expertise into the box, which also seems to matter. As long as intellectual property continues to be a major part of production, legal expertise will continue to be needed in decision making, and the lines between legal value-creators and legal guardians will remain blurry.

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Appendix A: Roles of GC in a Corporation

The General Counsel (GC), sometimes referred to as the Chief Legal Officer, is an important but rarely studied component of the governance system within a corporation. Legal research suggests four distinct roles played by GCs.¹⁹

1. Compliance officer

GC plays a pivotal role in legal compliance and promoting corporate integrity. GCs are responsible for compliance of SEC filings (such as annual reports, proxy statements etc.), and accurate reporting of financial statement and information dissemination. Securities laws and the policies of securities regulators and stock exchanges require prompt disclosure of all material information, both financial and non-financial, through many other channels including news media. GCs accountabilities include making sure that material information is revealed in a timely manner and that all investors are informed. In addition, they have an ongoing role to proactively assess and control legal risks and assist corporations on a daily basis to detect actions that could lead to corporate liability (Lipson et al. 2012).

Recent accounting papers (Jagolinzer, Larcker, and Taylor (2011), Kwak, Ro, and Suk (2012) and Hopkins, Maydew, and Venkatachalam (2012)) investigate GC's compliance role in corporate disclosure of accounting earnings, reporting quality and insider trading policies.

2. Gatekeeper (policing)

GC is the guardian of a firm on behalf of shareholders. According to ex-chairman of the SEC Christopher Cox, general counsels are "crucial gatekeepers responsible for safeguarding shareholders' interest." Their roles in non-compliance related monitoring are emphasized since SOX.

As a result of the perceived complicity of attorneys in the accounting frauds that surfaced between 2000 and 2002, Congress turned its attention to the duties of lawyers as corporate "gatekeepers" in the Sarbanes-Oxley Act of 2002. SOX Section 307 emphasizes the responsibility of the GC as an internal governance mechanism for transparent disclosure. Pursuant to Section 307 of SOX, the SEC adopted minimum standards of professional conduct for attorneys, which require, among other things, attorneys to report evidence of material

¹⁹ During the last few decades the role of outside counsel has shifted somewhat. The use of outside lawyers is still ubiquitous and continual. However, these lawyers serve a slightly different role, handling project-specific needs for legal counsel, where a project might be a particular litigation case or transactions of the firm (mergers, issuances, etc.).

violations of securities laws or any breaches of fiduciary duties “up-the-ladder” within the company. GCs are required to “report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company.” GCs could be held liable for management misconduct.

SOX provided the SEC with the necessary power to discipline attorneys. Section 602, which codified the SEC’s Rule of Practice 102(e)(1)(i)-(iii), gives the SEC authority to “censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission” if that person “willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or rules and regulations thereunder.” Section 602 further gives the SEC authority to impose these penalties against attorneys who are deemed to be unqualified to represent others, lack character or integrity, or have engaged in unethical or improper professional conduct. Since SOX, the SEC has adopted a more aggressive prosecutorial role against in-house counsel. As a result, GCs face harsh sanctions upon conviction of misconduct that violates the securities law, and some there is at least some evidence that GCs enforces internal governance on manager misconduct (DeMott, 2012).

3. Advisor (executive officer)

The most widely recognized and far-reaching duty of GCs is to provide legal advice to the entity including its directors and officers (Duggin, 2006; Heineman, 2012). GCs generally report directly to the CEO or the chairman of the board (Rostain (2008)). As a core member of the senior management team, GC is now the go-to counselor for the CEO and the board on law, ethics, public policy and other related issues. GC not only offers advice to law-related matters such as litigation, tax, environmental law etc. but also provides opinions to help shape discussions about business issues such as merger & acquisitions, intellectual property, trade, labor etc. According to Rostain (2008), the GCs, not the CEOs, are often responsible for determining the appropriate level of legal risks to be undertaken by their companies.

4. Supervisor and facilitator

They are in charge of the in-house legal department and act as facilitator in dealing with outside law firms and other third parties.

Appendix B: Historical Trend on the Roles of GC

DeMott (2005) and Lipson, Engel, and Crespo (2012) provide comprehensive reviews of the historical background on the development of GC roles. This appendix largely builds off their work. During the post-Civil War period, judges were lured from federal and state courts to serve as general counsel of railroads companies. Up to the 1930s GC held positive reputation and status, well regarded and compensated. Their role started to diminish noticeably in the 1940s as large law firms sought to control corporate representation. The GC's position was viewed as inferior to that at an outside law firm. They were regarded as lawyers who had not quite made to the partner at outside law firms. Their responsibilities were limited to handling routine matters in a corporation and served as liaison person between the management and the counsel's former law firm. With the increased costs of legal services in the 1970s the GC's position in many large corporations grew in stature and scope of responsibility. Corporate legal departments grew significantly. The number of in-house lawyers grew by 40% between 1970 and 1980 (Lipson, Engel, and Crespo (2012)). GC's role continued to grow significantly in the 1980s. One explanation for their enhanced status is due to the nature of the advisory services they provide to the top management. They were expected to provide high-level strategic advice to top management and the board with their intimate knowledge of the corporation, which allows them to be able to bear business insight in addition to legal skill (DeMott (2005)).

From the late 1980s, in-house legal departments began attracting high quality practitioners, and by the 1990s partners at elite law firms were attracted for in-house positions. For example, at GE sixty percent of GE's legal work was performed by outside counsel and forty percent by in-house counsel in 1990, but by year 2000 those numbers reversed (Schwarcz (2008)). It's more and more evident that the GC simultaneously held other offices. A high percentage of GC holds other corporate titles such as corporate secretary and vice president. In addition to their professional obligations, GC owes fiduciary allegiance to the corporation as officers. Being corporate secretary strengthens their connections to the board and offers sources of authority to GC's dealings with company directors and officers..

In-house legal departments had great control over the hiring of outside law firms and began spreading outsources work to many law firms in order to drive down legal costs .The outside law firm's power was reduced and law firms had to compete for business companies sent

to them. More and more transactional work is now handled by in-house counsel. Chayes and Chayes (1985) suggest that GC actively gets involved in early stage of transactional planning and prevention. Although outside counsel has been known to deal with major transactions such as acquisitions and major new product development, the GC often participates in the early discussions and engages outside counsel to analyze possible legal complications long before the deal is struck.

Sorkin (2012) attributes the increasing demand for internal lawyers rather than external legal counsel to the profit focus instead of client service focus by these big law firms. Heineman (2012) argues that the rising popularity of hiring general counsel is due to the increased benefits that in house lawyers can bring in comparison to outside law firms that care only about billable hours. These internal lawyers help a company improve productivity, achieve performance goals, and promote integrity. GCs are often among the top managers that are rewarded with incentives aligned with the interests of shareholders. The rise of the general counsel is also due to SOX, which emphasized the governance and monitoring role of the general counsel.

Recently, many large corporations started to hire former Attorney Generals of the United States, former White House counsel, former federal district court judges, and senior partners at prestigious law firms to be their GCs. Given the predominant role GCs play in corporate legal compliance, governance, and related matters, Super Lawyers, a publication by Thomson Reuters that nominates top lawyers in the U.S., recently launched its Business Edition, which profiled GCs of well-known companies.

Figure 1 ExecGC Career Trajectory

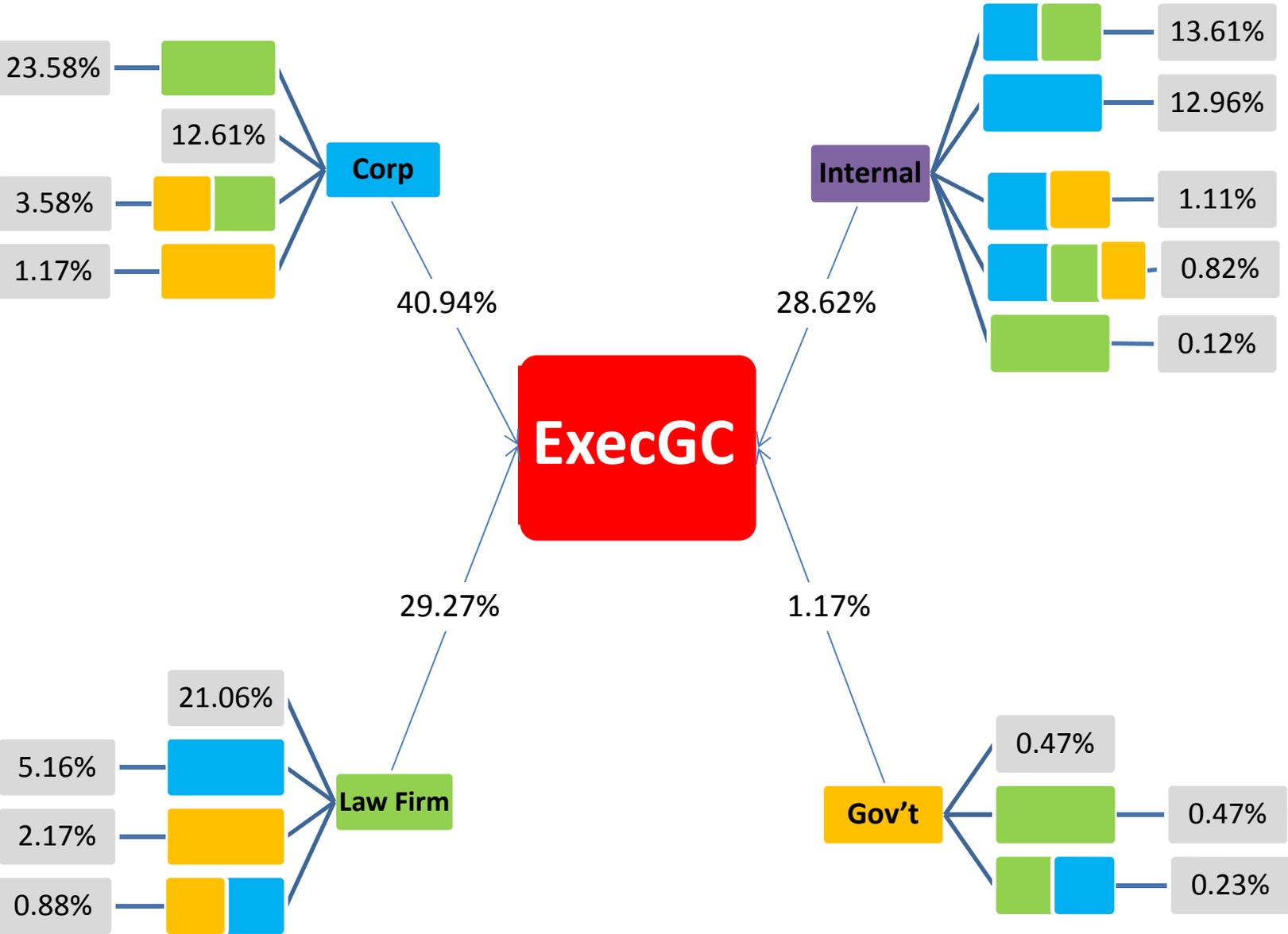


Table 1: Summary Stats (average) of ExecGC Characteristics by Fiscal Year

This table presents ExecGC characteristics by fiscal year. Our sample comprises firm years in ExecuComp from 1995 to 2012. Statistics reported in (1) and (2) are for the whole sample while statistics reported in (3)-(12) are for firm years with the presence of ExecGC. Variable definitions are provided in Appendix Table 1.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
Year	N	ExecGC	Director	Female	Age	GC pay	CEO pay	GC pay / CEO pay	GC % ownership	CEO % ownership	GC Delta	CEO Delta
1994	245	0.278	0.103	0.118	47.6	851	3,507	0.377	0.427	5.121	0.014	0.312
1995	1,727	0.328	0.071	0.090	49.3	965	4,252	0.344	0.338	3.506	0.022	0.341
1996	1,926	0.320	0.068	0.086	49.5	1,262	6,276	0.364	0.357	3.446	0.030	0.400
1997	1,993	0.330	0.053	0.078	49.5	1,380	7,746	0.353	0.348	3.620	0.039	0.494
1998	2,030	0.353	0.053	0.086	49.7	1,495	11,702	0.335	0.355	3.420	0.043	0.507
1999	1,928	0.377	0.047	0.103	49.9	1,835	9,351	0.381	0.372	4.005	0.061	0.546
2000	1,831	0.397	0.048	0.109	50.1	1,952	10,348	0.346	0.405	3.794	0.059	0.588
2001	1,786	0.410	0.045	0.131	50.4	1,632	8,557	0.353	0.359	3.442	0.045	0.538
2002	1,821	0.425	0.036	0.138	50.5	1,342	6,300	0.369	0.377	3.298	0.038	0.418
2003	1,866	0.429	0.036	0.134	50.8	1,446	6,563	0.335	0.371	3.111	0.054	0.552
2004	1,810	0.408	0.039	0.140	51.1	1,464	6,918	0.345	0.354	2.851	0.064	0.558
2005	1,697	0.357	0.046	0.127	51.8	1,722	7,159	0.358	0.335	2.879	0.081	0.589
2006	1,857	0.377	0.031	0.134	51.3	1,196	4,793	0.416	0.292	2.860	0.074	0.589
2007	1,856	0.395	0.038	0.139	51.2	1,175	4,101	0.442	0.260	2.797	0.064	0.532
2008	1,789	0.410	0.030	0.140	51.2	973	3,357	0.414	0.243	2.369	0.038	0.319
2009	1,726	0.412	0.027	0.143	51.5	1,352	4,944	0.398	0.259	2.440	0.045	0.354
2010	1,665	0.465	0.022	0.149	51.9	1,136	4,042	0.394	0.234	2.210	0.048	0.410
2011	1,592	0.465	0.018	0.155	52.4	982	3,545	0.402	0.235	2.044	0.047	0.364
2012	1,465	0.438	0.017	0.170	53.3	1,543	3,401	0.432	0.233	1.945	0.054	0.396
All	32,610	0.391	0.040	0.126	50.9	1,379	6,252	0.378	0.309	2.974	0.050	0.471

Table 2: Summary Stats (Mean) by ExecGC Sources

This table presents the mean of compensation, firm characteristics, governance outcome, risk-taking variables and other governance measures taken in the year of ExecGC hiring by the three different career sources from which ExecGCs are hired, i.e., internal promoted, externally hired from law firms, and externally hired from other corporations. Firms with no ExecGC include firm years where there is no ExecGC in a six-year window (i.e., from two years prior to three years after). Our sample comprises firm years in ExecuComp from 1995 to 2012. Variable definitions are provided in Appendix Table 1.

	Internal	External- Law Firms	External- Corporation	All sources	Firms with no ExecGC
# of Obs.	221	213	363	797	8,536
Compensation					
ExecGC totpay	882	965	1019	967	
CEO totpay	5,610	5,592	5,814	5,699	
ExecGC pay / CEO pay	0.310	0.325	0.320	0.318	
ExecGC delta	0.019	0.015	0.015	0.016	
CEO delta	0.558	0.540	0.472	0.514	
Firm characteristics					
Assets	17,091	21,652	13,827	16,823	19,616
Sales	10,388	7,026	5,383	7,210	6,328
MTB	1.391	1.685	1.547	1.540	1.769
Salegrowth	0.147	0.341	0.296	0.267	0.278
Z Score	3.775	5.317	4.122	4.335	6.166
Buy&hold mkt adj. return	0.041	0.083	0.055	0.058	0.118
Profit	-0.057	-0.157	-0.026	-0.070	0.035
Prob_sued	0.023	0.019	0.022	0.021	0.019
Governance outcome					
Class Action	0.041	0.070	0.036	0.046	0.027
Backdating	0.258	0.310	0.335	0.308	0.292
Fraud Score	1.074	1.235	1.154	1.154	1.170
Manipulation Score	-2.537	-2.575	-2.661	-2.603	-2.508
AAER Fraud	0.024	0.034	0.044	0.036	0.024
Risk-taking					
Investment_int	0.000	0.001	0.001	0.001	0.001
R&D	0.036	0.044	0.044	0.041	0.044
Acquisition	0.020	0.034	0.026	0.026	0.022
Volatility	0.427	0.487	0.516	0.483	0.472
Other governance measures					
Institutional Ownpct	0.622	0.624	0.603	0.614	0.619
Institutional Ownpct HHI	0.056	0.059	0.055	0.056	0.058
Blockholder	0.719	0.728	0.716	0.720	0.753
Board independence	0.721	0.667	0.701	0.697	0.662
Board size	9.897	9.473	9.324	9.528	9.330
Governance Index	9.776	9.057	9.383	9.403	8.762

Table 3: Governance, Investment, and Risk-taking around ExecGC Hiring by the Three Sources

This table presents the mean of governance outcome, investment and risk-taking, and corporate governance measure for both two years prior and three years subsequent to the year of ExecGC hiring by three hiring sources, i.e., internal promoted, externally hired from law firms, and externally hired from corporation. Firms with no ExecGC include firm years where there is no ExecGC in a six-year window (i.e., from two years prior to three years after). The last column shows the p-values of t-tests in the difference between the mean of two years prior to hiring and the mean of three years after hiring for separate groups. The difference-in-difference test is between firms with externally hired ExecGC and firms with no ExecGC, and is one-sided, with prior belief of ExecGCs associated with improved governance, reduced investment and risk-taking, and better governance through alternative mechanisms. Our sample comprises firm years in ExecuComp from 1995 to 2012. Variable definitions are provided in Appendix Table 1.

ExecGC by hiring sources (year 0 is the hiring year)	# of obs	Before Mean (Year -2 to -1)	After Mean (Year +1 to +3)	Diff (after - before)	P-value of difference test
Panel A: Governance Outcome					
<u>Class Action</u>					
Internal	221	0.0362	0.0430	0.0068	0.6423
External-Law Firms	213	0.0798	0.0681	-0.0117	0.5683
External-Corporation	363	0.0399	0.0354	-0.0046	0.6822
ExecGC from all sources	797	0.0496	0.0462	-0.0033	0.6943
ExecGC from external sources	576	0.0547	0.0475	-0.0072	0.4853
Firms with no ExecGC	8,536	0.0247	0.0286	0.0039	0.0429
Diff in diff (External ExecGC - no ExecGC)				-0.0112	0.0798
<u>Backdating</u>					
Internal	87	0.2644	0.2682	0.0038	0.9387
External-Law Firms	108	0.3148	0.2963	-0.0185	0.6953
External-Corporation	156	0.3365	0.2746	-0.0620	0.1265
ExecGC from all sources	351	0.3120	0.2797	-0.0323	0.2170
ExecGC from external sources	264	0.3277	0.2835	-0.0442	0.1503
Firms with no ExecGC	3,745	0.3242	0.2745	-0.0497	0.0000
Diff in diff (External ExecGC - no ExecGC)				0.0174	0.7398
<u>Fraud Score</u>					
Internal	221	1.0974	1.0324	-0.0650	0.0277
External-Law Firms	212	1.3376	1.1618	-0.1758	0.0037
External-Corporation	360	1.2387	1.0565	-0.1822	0.0003
ExecGC from all sources	793	1.2258	1.0779	-0.1478	0.0003
ExecGC from external sources	572	1.2754	1.0955	-0.1798	0.0000
Firms with no ExecGC	8,514	1.2037	1.1394	-0.0643	0.0003
Diff in diff (External ExecGC - no ExecGC)				-0.1155	0.0036
<u>Manipulation Score</u>					
Internal	218	-2.5694	-2.7046	-0.1353	0.0570
External-Law Firms	210	-2.3902	-2.6144	-0.2242	0.0174
External-Corporation	353	-2.4302	-2.6719	-0.2417	0.0202
ExecGC from all sources	781	-2.4583	-2.6656	-0.2073	0.0003
ExecGC from external sources	563	-2.4153	-2.6504	-0.2352	0.0015
Firms with no ExecGC	8,237	-2.4413	-2.5701	-0.1289	0.0003
Diff in diff (External ExecGC - no ExecGC)				-0.1063	0.0147
<u>AAER Fraud</u>					
Internal	151	0.0464	0.0364	-0.0099	0.6181
External-Law Firms	157	0.0573	0.0425	-0.0149	0.4283
External-Corporation	255	0.0412	0.0222	-0.0190	0.1449
ExecGC from all sources	563	0.0471	0.0317	-0.0154	0.1049
ExecGC from external sources	412	0.0473	0.0299	-0.0174	0.1054
Firms with no ExecGC	6,359	0.0234	0.0255	0.0021	0.2228
Diff in diff (External ExecGC - no ExecGC)				-0.0175	0.0030

Panel B: Investment and risk-taking**Investment int**

Internal	214	0.0004	0.0002	-0.0002	0.0182
External-Law Firms	203	0.0008	0.0004	-0.0004	0.0463
External-Corporation	348	0.0007	0.0006	-0.0002	0.1519
ExecGC from all sources	765	0.0006	0.0004	-0.0002	0.0021
ExecGC from external sources	551	0.0007	0.0005	-0.0002	0.0157
Firms with no ExecGC	8,259	0.0010	0.0008	-0.0002	0.1833

Diff in diff (External ExecGC - no ExecGC)**0.0000 0.4636****R&D**

Internal	217	0.0360	0.0331	-0.0029	0.0523
External-Law Firms	213	0.0392	0.0335	-0.0057	0.1295
External-Corporation	361	0.0429	0.0444	0.0015	0.4039
ExecGC from all sources	791	0.0400	0.0384	-0.0016	0.2338
ExecGC from external sources	574	0.0415	0.0403	-0.0012	0.5192
Firms with no ExecGC	8,515	0.0458	0.0435	-0.0023	0.0000

Diff in diff (External ExecGC - no ExecGC)**0.0011 0.7463****Acquisition**

Internal	221	0.0235	0.0208	-0.0026	0.4297
External-Law Firms	213	0.0322	0.0262	-0.0061	0.1559
External-Corporation	363	0.0245	0.0216	-0.0028	0.2786
ExecGC from all sources	797	0.0263	0.0226	-0.0037	0.0538
ExecGC from external sources	576	0.0273	0.0233	-0.0040	0.0773
Firms with no ExecGC	8,536	0.0234	0.0218	-0.0016	0.0024

Diff in diff (External ExecGC - no ExecGC)**-0.0025 0.1140****Volatility**

Internal	221	0.4387	0.4466	0.0079	0.7009
External-Law Firms	212	0.4629	0.5123	0.0494	0.0181
External-Corporation	358	0.4920	0.4774	-0.0146	0.3038
ExecGC from all sources	791	0.4693	0.4782	0.0088	0.3895
ExecGC from external sources	570	0.4812	0.4904	0.0092	0.4368
Firms with no ExecGC	8,461	0.4664	0.4572	-0.0091	0.0005

Diff in diff (External ExecGC - no ExecGC)**0.0184 0.9583**

Panel C: Corporate Governance**Institutional ownpct**

Internal	202	0.5659	0.6413	0.0754	0.0000
External-Law Firms	201	0.5501	0.6571	0.1070	0.0000
External-Corporation	328	0.5329	0.6210	0.0881	0.0000
ExecGC from all sources	731	0.5467	0.6365	0.0898	0.0000
ExecGC from external sources	529	0.5394	0.6347	0.0952	0.0000
Firms with no ExecGC	8,094	0.5625	0.6546	0.0921	0.0000

Diff in diff (External ExecGC - no ExecGC)**0.0032 0.3513****Institutional ownpct HHI**

Internal	202	0.0561	0.0512	-0.0049	0.3787
External-Law Firms	201	0.0589	0.0531	-0.0058	0.3707
External-Corporation	328	0.0578	0.0640	0.0062	0.2975
ExecGC from all sources	731	0.0577	0.0575	-0.0002	0.9657
ExecGC from external sources	529	0.0582	0.0599	0.0017	0.7098
Firms with no ExecGC	8,094	0.0587	0.0577	-0.0010	0.2304

Diff in diff (External ExecGC - no ExecGC)**0.0027 0.2243****Blockholder**

Internal	202	0.6733	0.7649	0.0916	0.0002
External-Law Firms	201	0.6791	0.7844	0.1053	0.0000
External-Corporation	328	0.6585	0.7536	0.0950	0.0000
ExecGC from all sources	731	0.6683	0.7652	0.0969	0.0000
ExecGC from external sources	529	0.6664	0.7653	0.0989	0.0000
Firms with no ExecGC	8,094	0.7041	0.7858	0.0817	0.0000

Diff in diff (External ExecGC - no ExecGC)**0.0172 0.1271****Board Indpendence**

Internal	180	70.0977	75.7518	5.6542	0.0000
External-Law Firms	172	65.2980	70.2043	4.9064	0.0000
External-Corporation	274	67.9859	73.1918	5.2060	0.0000
ExecGC from all sources	626	67.8546	73.1071	5.2525	0.0000
ExecGC from external sources	446	66.9493	72.0397	5.0904	0.0000
Firms with no ExecGC	6,761	64.4340	69.5154	5.0814	0.0000

Diff in diff (External ExecGC - no ExecGC)**0.0091 0.4931****Board Size**

Internal	180	10.0611	9.9426	-0.1185	0.2464
External-Law Firms	172	9.5291	9.5203	-0.0087	0.9379
External-Corporation	274	9.3996	9.2634	-0.1363	0.1262
ExecGC from all sources	626	9.6254	9.5293	-0.0961	0.0952
ExecGC from external sources	446	9.4496	9.3625	-0.0871	0.2110
Firms with no ExecGC	6,761	9.3800	9.4361	0.0560	0.0015

Diff in diff (External ExecGC - no ExecGC)**-0.1431 0.0221****Governance Index**

Internal	122	9.5615	9.9604	0.3989	0.0000
External-Law Firms	106	9.1604	9.6824	0.5220	0.0000
External-Corporation	182	9.3214	9.7051	0.3837	0.0000
ExecGC from all sources	410	9.3512	9.7752	0.4240	0.0000
ExecGC from external sources	288	9.2622	9.6968	0.4346	0.0000
Firms with no ExecGC	4,469	8.7007	9.0868	0.3861	0.0000

Diff in diff (External ExecGC - no ExecGC)**0.0485 0.7939**

Table 4: Executive General Counsel and Governance Outcome

This table presents difference in difference tests on ExecGC and governance outcome. The treatment group is firms that hire ExecGCs, and the control group is firms that are matched within the year-industry and litigation risk and do not have ExecGC in a six-year window (i.e., from two years prior to three years after). Our sample comprises firm years in ExecuComp from 1995 to 2012. Variable definitions are provided in Appendix Table 1. Standard errors are clustered at the firm level. Superscripts ***, **, * indicate statistical significance level at the 1%, 5%, and 10% level, respectively.

	(1)	(2)	(3)	(4)	(5)
	Class Action	Backdating	Fraud Score	Manipulation	AAER Fraud
	OLS	OLS	OLS	Score	OLS
	OLS	OLS	OLS	OLS	OLS
Post	0.0232**	-0.039	0.0197	-0.00258	0.00418
	[0.0108]	[0.0403]	[0.0448]	[0.0793]	[0.00902]
Treated	0.0328***	0.012	0.107**	-0.0117	0.0232**
	[0.0109]	[0.0249]	[0.0446]	[0.0452]	[0.0105]
Post*treated	-0.0162	0.0272	-0.129***	-0.014	-0.0272**
	[0.0129]	[0.0343]	[0.0485]	[0.0655]	[0.0119]
Clustered s.e. at firm-hire year level	Y	Y	Y	Y	Y
Hire Year F.E.	Y	Y	Y	Y	Y
Year F.E.	Y	Y	Y	Y	Y
SIC One Digit F.E.	Y	Y	Y	Y	Y
Year * SIC One Digit F.E.	Y	Y	Y	Y	Y
SIC Two Digit F.E.	Y	Y	Y	Y	Y
Observations	7,060	2,984	7,030	6,855	5,256
R-squared	0.054	0.071	0.121	0.066	0.052

Table 5: Executive General Counsel and Corporate Investment and Risk-taking

This table presents difference in difference tests on ExecGC and corporate investment and risk-taking. The treatment group is firms that hire ExecGCs, and the control group is firms that are matched within the year-industry and litigation risk and do not have ExecGC in a six-year window (i.e., from two years prior to three years after). Our sample comprises firm years in ExecuComp from 1995 to 2012. Variable definitions are provided in Appendix Table 1. Standard errors are clustered at the firm level. Superscripts ***, **, * indicate statistical significance level at the 1%, 5%, and 10% level, respectively.

	(1)	(2)	(3)	(4)
	Log (investment_intensity)			
	t+1	R&D t+1	Acquisition t+1	Log(volatility) t+1
	OLS	OLS	OLS	OLS
Post	0.0335 [0.0292]	0.0029 [0.00248]	-0.000369 [0.00332]	0.00954 [0.0165]
Treated	0.0697*** [0.0268]	-0.00368 [0.00296]	0.00112 [0.00240]	0.0575*** [0.0152]
Post*treated	-0.0173 [0.0326]	-0.000487 [0.00224]	0.000142 [0.00287]	0.0119 [0.0162]
Log(assets)	-1.028*** [0.0261]	0.00685* [0.00352]	0.00653*** [0.00167]	-0.0513*** [0.0145]
Log(sales)	-0.00386 [0.0267]	-0.0163*** [0.00504]	-0.00816*** [0.00190]	-0.0568*** [0.0150]
Leverage	-0.115 [0.0882]	0.0338** [0.0147]	0.00731 [0.00545]	0.201*** [0.0433]
Log(cash)	0.0624*** [0.00973]	0.00803*** [0.00108]	-0.00563*** [0.000812]	0.0689*** [0.00566]
log(salegrowth)	0.278*** [0.0524]	-0.0129** [0.00585]	0.0227*** [0.00327]	0.0828*** [0.0209]
Log(mktbk)	0.177*** [0.0249]	0.0164*** [0.00392]	0.00473*** [0.00150]	-0.118*** [0.0123]
Return	-0.0511*** [0.0180]	-0.00506*** [0.00178]	-0.00303*** [0.00114]	0.0491*** [0.00782]
Log(age)	-0.0579 [0.103]	0.00797 [0.00997]	-0.00308 [0.00730]	-0.0981* [0.0583]
Clustered s.e. at firm-hire year level	Y	Y	Y	Y
Hire Year F.E.	Y	Y	Y	Y
Year F.E.	Y	Y	Y	Y
SIC One Digit F.E.	Y	Y	Y	Y
Year * SIC One Digit F.E.	Y	Y	Y	Y
SIC Two Digit F.E.	Y	Y	Y	Y
Observations	6,393	6,894	6,937	6,935
R-squared	0.926	0.469	0.13	0.631

Table 6 Executive General Counsel Incentive Pay and Corporate Investment and Risk-taking

This table presents difference in difference tests on ExecGC incentive pay and corporate investment and risk-taking. The treatment group is corporations hiring ExecGCs from other corporations, and the control group is firms that are matched within the year-inindustry and litigation risk and hire ExecGCs from law firms. Panel A presents baseline results while Panel B further considers two-digit SIC industry fixed effects and Panel C further considers incentive and bonus paid to ExecGC in the hire year to find matched firms. Our sample comprises firm years in ExecuComp from 1995 to 2012. Variable definitions are provided in Appendix Table 1. Standard errors are clustered at the firm level. Superscripts ***, **, * indicate statistical significance level at the 1%, 5%, and 10% level, respectively.

Panel A	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Log (investment_intensity) t+1				R&D t+1			
Post	0.0864 [0.0823]	0.104 [0.0831]	0.0931 [0.0846]	0.0802 [0.0841]	-0.00786 [0.0115]	-0.00755 [0.0116]	-0.00936 [0.0116]	-0.0088 [0.0115]
Treatment (Hire=Corporate)	-0.00179 [0.0698]	-0.00267 [0.0699]	-0.00265 [0.0699]	-0.00323 [0.0699]	-0.00689 [0.00761]	-0.00691 [0.00760]	-0.00642 [0.00791]	-0.0064 [0.00790]
Post*Treatment	-0.0377 [0.0710]	-0.096 [0.0739]	-0.099 [0.0760]	-0.0446 [0.0733]	0.0132** [0.00564]	0.0113** [0.00562]	0.0124* [0.00660]	0.0136** [0.00659]
Post*GCDelta_Hireyear		-1.389** [0.540]	-1.59 [1.127]			-0.00508 [0.0531]	0.0952 [0.0800]	
Post*Treat*GCDelta_Hireyear		5.469*** [1.546]	5.395*** [1.736]			0.15 [0.152]	0.0636 [0.153]	
Post*CEODelta_Hireyear			-0.0145 [0.00943]	-0.0204* [0.0116]			0.00103 [0.000791]	0.00134 [0.000978]
Post*Treat*CEODelta_Hireyear			0.0155 [0.0135]	0.0182 [0.0145]			-0.00180* [0.00104]	-0.00219* [0.00115]
Log(assets)	-1.022*** [0.0450]	-1.021*** [0.0450]	-1.013*** [0.0467]	-1.007*** [0.0473]	0.0125** [0.00575]	0.0125** [0.00570]	0.0114** [0.00576]	0.0113* [0.00578]
Log(sales)	-0.00564 [0.0458]	-0.00499 [0.0448]	-0.00958 [0.0463]	-0.0141 [0.0467]	-0.0221*** [0.00787]	-0.0221*** [0.00786]	-0.0203** [0.00793]	-0.0200** [0.00788]
Leverage	-0.109 [0.146]	-0.0954 [0.146]	-0.0883 [0.151]	-0.092 [0.151]	0.0367* [0.0217]	0.0377* [0.0216]	0.0299* [0.0155]	0.0286* [0.0155]
Log(cash)	0.0631*** [0.0222]	0.0666*** [0.0226]	0.0714*** [0.0228]	0.0714*** [0.0227]	0.00965*** [0.00224]	0.00969*** [0.00223]	0.00920*** [0.00211]	0.00919*** [0.00212]
log(salegrowth)	0.0749 [0.0675]	0.0732 [0.0666]	0.106 [0.0704]	0.107 [0.0715]	-0.0387** [0.0188]	-0.0387** [0.0189]	-0.0324 [0.0204]	-0.0325 [0.0204]
Log(mktbk)	0.181*** [0.0456]	0.176*** [0.0466]	0.174*** [0.0470]	0.180*** [0.0455]	0.0229*** [0.00577]	0.0223*** [0.00596]	0.0191*** [0.00437]	0.0199*** [0.00422]
Return	0.0234 [0.0342]	0.0225 [0.0349]	0.00742 [0.0348]	0.00864 [0.0339]	0.00595 [0.0113]	0.00628 [0.0116]	0.00759 [0.0126]	0.00709 [0.0122]
Log(age)	0.401* [0.215]	0.409* [0.213]	0.374* [0.215]	0.372* [0.217]	0.0173 [0.0143]	0.0168 [0.0143]	0.018 [0.0142]	0.0193 [0.0141]
Clustered s.e. at firm-hire year level	Y	Y	Y	Y	Y	Y	Y	Y
Hire Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y
Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y
SIC One Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y
Year * SIC One Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y
SIC Two Digit F.E.	N	N	N	N	N	N	N	N
Matched on Bonus Level	N	N	N	N	N	N	N	N
Observations	1,715	1,712	1,674	1,677	1,835	1,832	1,789	1,792
R-squared	0.905	0.905	0.904	0.904	0.368	0.368	0.347	0.347

Panel A	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
	Acquisition t+1				Log(volatility) t+1			
Post	0.00171 [0.00664]	0.00226 [0.00666]	1.60E-05 [0.00670]	-0.000615 [0.00670]	0.0581 [0.0436]	0.0669 [0.0445]	0.0548 [0.0462]	0.0343 [0.0447]
Treatment (Hire=Corporate)	-0.00607 [0.00480]	-0.00609 [0.00480]	-0.00605 [0.00477]	-0.00603 [0.00478]	-0.0102 [0.0348]	-0.011 [0.0347]	-0.00942 [0.0347]	-0.00996 [0.0348]
Post*Treatment	-0.00199 [0.00520]	-0.00487 [0.00547]	-0.00385 [0.00558]	-0.00106 [0.00533]	-0.0459 [0.0364]	-0.0585 [0.0397]	-0.0528 [0.0416]	-0.0254 [0.0388]
Post*GCDelta_Hireyear		-0.0207 [0.0236]	-0.0353 [0.0587]			-0.606 [0.515]	-2.204** [0.880]	
Post*Treat*GCDelta_Hireyear		0.338** [0.147]	0.336** [0.150]			-0.46 [0.863]	0.959 [1.019]	
Post*CEODelta_Hireyear			-0.000956** [0.000392]	-0.00114*** [0.000405]			0.0307*** [0.0103]	0.0236 [0.0165]
Post*Treat*CEODelta_Hireyear			0.00102* [0.000527]	0.00133** [0.000536]			-0.0235** [0.0113]	-0.0218 [0.0174]
Log(assets)	-0.00207 [0.00184]	-0.00259 [0.00179]	-0.0017 [0.00178]	-0.00113 [0.00181]	-0.0903*** [0.0297]	-0.0809*** [0.0291]	-0.0862*** [0.0289]	-0.0888*** [0.0301]
Log(sales)	0.000643 [0.00221]	0.000815 [0.00219]	0.000154 [0.00221]	-0.00004 [0.00221]	-0.0171 [0.0248]	-0.0207 [0.0243]	-0.0205 [0.0239]	-0.0233 [0.0248]
Leverage	-0.00755 [0.0123]	-0.00711 [0.0123]	-0.00546 [0.0128]	-0.00588 [0.0128]	0.325*** [0.102]	0.345*** [0.0997]	0.342*** [0.102]	0.332*** [0.104]
Log(cash)	-0.00007 [0.00110]	-0.00001 [0.00108]	-0.00002 [0.00110]	-0.00006 [0.00113]	0.0736*** [0.0106]	0.0753*** [0.0106]	0.0710*** [0.0106]	0.0715*** [0.0107]
log(salegrowth)	0.0108*** [0.00367]	0.0104*** [0.00366]	0.0106*** [0.00379]	0.0110*** [0.00379]	0.0258 [0.0385]	0.0304 [0.0380]	0.0365 [0.0385]	0.0338 [0.0391]
Log(mktbk)	0.00614* [0.00346]	0.00611* [0.00339]	0.00642* [0.00348]	0.00651* [0.00355]	-0.0274 [0.0344]	-0.0366 [0.0306]	-0.0355 [0.0313]	-0.0306 [0.0351]
Return	-0.00112 [0.00212]	-0.000957 [0.00217]	-0.00135 [0.00212]	-0.00154 [0.00208]	0.0264 [0.0161]	0.0291* [0.0166]	0.0283* [0.0170]	0.0268 [0.0164]
Log(age)	0.00196 [0.0116]	0.00104 [0.0116]	0.000212 [0.0116]	0.000819 [0.0116]	-0.163 [0.101]	-0.152 [0.102]	-0.141 [0.0998]	-0.158 [0.0997]
Clustered s.e. at firm-hire year level	Y	Y	Y	Y	Y	Y	Y	Y
Hire Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y
Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y
SIC One Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y
Year * SIC One Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y
SIC Two Digit F.E.	N	N	N	N	N	N	N	N
Matched on Bonus Level	N	N	N	N	N	N	N	N
Observations	1,851	1,848	1,805	1,808	1,838	1,835	1,793	1,796
R-squared	0.136	0.141	0.142	0.138	0.563	0.572	0.58	0.567

Panel B	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Log (investment_intensity) t+1				R&D t+1			
Post	0.136 [0.0828]	0.148* [0.0831]	0.133 [0.0849]	0.132 [0.0840]	-0.00711 [0.0110]	-0.0064 [0.0109]	-0.00788 [0.0109]	-0.0078 [0.0109]
Treatment (Hire=Corporate)	0.0408 [0.0637]	0.0391 [0.0634]	0.0388 [0.0635]	0.0397 [0.0637]	-0.00947 [0.00790]	-0.00965 [0.00792]	-0.00906 [0.00829]	-0.00894 [0.00827]
Post*Treatment	-0.0505 [0.0706]	-0.0899 [0.0729]	-0.0875 [0.0758]	-0.0561 [0.0729]	0.0128** [0.00542]	0.00905* [0.00488]	0.0102* [0.00582]	0.0134** [0.00636]
Post*GCDelta_Hireyear		-0.915* [0.486]	-0.0568 [1.186]			-0.0383 [0.0483]	0.0446 [0.0723]	
Post*Treat*GCDelta_Hireyear		3.816*** [1.347]	2.862* [1.713]			0.269* [0.144]	0.197 [0.141]	
Post*CEODelta_Hireyear			-0.0161 [0.0116]	-0.0172 [0.0114]			0.000865 [0.000620]	0.00101 [0.000671]
Post*Treat*CEODelta_Hireyear			0.0164 [0.0145]	0.0151 [0.0134]			-0.00217** [0.000895]	-0.00256*** [0.000962]
Log(assets)	-0.941*** [0.0409]	-0.944*** [0.0411]	-0.933*** [0.0420]	-0.926*** [0.0418]	0.0130* [0.00705]	0.0132* [0.00693]	0.0123* [0.00735]	0.0121 [0.00744]
Log(sales)	-0.0723* [0.0421]	-0.0715* [0.0420]	-0.0827** [0.0415]	-0.0855** [0.0414]	-0.0231** [0.00944]	-0.0236** [0.00940]	-0.0217** [0.00998]	-0.0212** [0.00997]
Leverage	-0.0458 [0.135]	-0.0505 [0.134]	-0.0385 [0.140]	-0.0359 [0.140]	0.0218 [0.0221]	0.0226 [0.0220]	0.0149 [0.0157]	0.0138 [0.0157]
Log(cash)	0.0609*** [0.0215]	0.0594*** [0.0217]	0.0644*** [0.0217]	0.0661*** [0.0216]	0.00711*** [0.00205]	0.00679*** [0.00205]	0.00624*** [0.00187]	0.00657*** [0.00189]
log(salegrowth)	0.128** [0.0628]	0.127** [0.0621]	0.160** [0.0662]	0.160** [0.0673]	-0.0391** [0.0184]	-0.0390** [0.0184]	-0.0329 [0.0200]	-0.0331 [0.0201]
Log(mktbk)	0.127*** [0.0445]	0.127*** [0.0450]	0.127*** [0.0450]	0.131*** [0.0444]	0.0199*** [0.00572]	0.0191*** [0.00581]	0.0158*** [0.00443]	0.0169*** [0.00443]
Return	0.0422 [0.0354]	0.0427 [0.0359]	0.0335 [0.0363]	0.031 [0.0351]	0.00669 [0.0115]	0.00717 [0.0118]	0.00858 [0.0127]	0.00798 [0.0124]
Log(age)	0.247 [0.206]	0.25 [0.205]	0.217 [0.208]	0.216 [0.210]	0.0177 [0.0134]	0.0176 [0.0133]	0.0175 [0.0132]	0.0182 [0.0132]
Clustered s.e. at firm-hire year level	Y	Y	Y	Y	Y	Y	Y	Y
Hire Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y
Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y
SIC One Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y
Year * SIC One Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y
SIC Two Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y
Matched on Bonus Level	N	N	N	N	N	N	N	N
Observations	1,715	1,712	1,674	1,677	1,835	1,832	1,789	1,792
R-squared	0.923	0.923	0.923	0.923	0.455	0.458	0.44	0.438

Panel B	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
	Acquisition t+1				Log(volatility) t+1			
Post	0.00166 [0.00681]	0.00249 [0.00683]	3.29E-04 [0.00687]	-0.00092 [0.00685]	0.0541 [0.0383]	0.062 [0.0389]	0.0502 [0.0410]	0.0299 [0.0401]
Treatment (Hire=Corporate)	-0.00734 [0.00488]	-0.00754 [0.00487]	-0.00719 [0.00483]	-0.00701 [0.00485]	-0.0122 [0.0334]	-0.0134 [0.0331]	-0.0116 [0.0331]	-0.0113 [0.0334]
Post*Treatment	-0.00228 [0.00526]	-0.00507 [0.00545]	-0.00416 [0.00551]	-0.0012 [0.00535]	-0.0389 [0.0353]	-0.0553 [0.0384]	-0.0484 [0.0406]	-0.0172 [0.0382]
Post*GCDelta_Hireyear		-0.044 [0.0318]	-0.111 [0.0749]			-0.558 [0.391]	-2.105*** [0.774]	
Post*Treat*GCDelta_Hireyear		0.319** [0.146]	0.364** [0.155]			-0.0472 [0.808]	1.426 [0.952]	
Post*CEODelta_Hireyear			-0.000875 [0.000585]	-0.00127*** [0.000487]			0.0316** [0.0139]	0.0264 [0.0185]
Post*Treat*CEODelta_Hireyear			0.000792 [0.000670]	0.00143** [0.000619]			-0.0277* [0.0153]	-0.0255 [0.0210]
Log(assets)	-0.00329 [0.00258]	-0.00392 [0.00251]	-0.00211 [0.00241]	-0.00128 [0.00243]	-0.0787*** [0.0270]	-0.0689** [0.0269]	-0.0749*** [0.0258]	-0.0789*** [0.0276]
Log(sales)	0.00166 [0.00305]	0.00191 [0.00303]	-0.0000438 [0.00299]	-4.65E-04 [0.00295]	-0.025 [0.0265]	-0.0319 [0.0269]	-0.032 [0.0264]	-0.0304 [0.0274]
Leverage	-0.00868 [0.0132]	-0.00852 [0.0134]	-0.00648 [0.0137]	-0.00629 [0.0136]	0.280*** [0.0841]	0.287*** [0.0842]	0.272*** [0.0829]	0.275*** [0.0843]
Log(cash)	0.00089 [0.00133]	0.00088 [0.00133]	0.00074 [0.00129]	0.00080 [0.00129]	0.0764*** [0.0119]	0.0733*** [0.0114]	0.0691*** [0.0109]	0.0736*** [0.0118]
log(salegrowth)	0.00934** [0.00388]	0.00900** [0.00389]	0.00927** [0.00405]	0.00960** [0.00404]	0.0389 [0.0372]	0.0442 [0.0368]	0.0516 [0.0366]	0.0471 [0.0372]
Log(mktbk)	0.00637 [0.00393]	0.00661* [0.00400]	0.00812** [0.00409]	0.00788** [0.00400]	-0.0836*** [0.0284]	-0.0910*** [0.0258]	-0.0862*** [0.0257]	-0.0842*** [0.0285]
Return	-0.00136 [0.00221]	-0.0013 [0.00228]	-0.00193 [0.00224]	-0.00199 [0.00218]	0.0347** [0.0145]	0.0387*** [0.0148]	0.0369** [0.0151]	0.0348** [0.0147]
Log(age)	-0.000626 [0.0115]	-0.00115 [0.0116]	-0.00104 [0.0116]	-0.00101 [0.0115]	-0.0454 [0.103]	-0.0367 [0.102]	-0.0153 [0.0962]	-0.0287 [0.0971]
Clustered s.e. at firm-hire year level	Y	Y	Y	Y	Y	Y	Y	Y
Hire Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y
Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y
SIC One Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y
Year * SIC One Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y
SIC Two Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y
Matched on Bonus Level	N	N	N	N	N	N	N	N
Observations	1,851	1,848	1,805	1,808	1,838	1,835	1,793	1,796
R-squared	0.171	0.175	0.178	0.174	0.651	0.66	0.668	0.656

Panel C	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Log (investment_intensity) t+1				R&D t+1			
Post	0.0606 [0.0818]	0.0767 [0.0825]	0.0706 [0.0845]	0.0553 [0.0828]	0.000206 [0.00461]	0.000571 [0.00468]	-0.00273 [0.00474]	-0.00215 [0.00457]
Treatment (Hire=Corporate)	0.0559 [0.0717]	0.0552 [0.0718]	0.0529 [0.0712]	0.0521 [0.0712]	0.00488 [0.00460]	0.00487 [0.00461]	0.00462 [0.00460]	0.00462 [0.00460]
Post*Treatment	-0.0683 [0.0711]	-0.106 [0.0733]	-0.104 [0.0753]	-0.0677 [0.0723]	0.00819** [0.00401]	0.00878** [0.00445]	0.0140** [0.00556]	0.0122** [0.00492]
Post*GCDelta_Hireyear		-1.312** [0.512]	-1.583 [1.454]			-0.0305 [0.0353]	0.041 [0.0778]	
Post*Treat*GCDelta_Hireyear		4.160* [2.252]	4.259* [2.502]			-0.0867 [0.156]	-0.182 [0.168]	
Post*CEODelta_Hireyear			-0.0175* [0.00957]	-0.0181* [0.00957]			0.000143 [0.000659]	0.000145 [0.000660]
Post*Treat*CEODelta_Hireyear			0.0158 [0.0141]	0.0155 [0.0141]			-0.00146 [0.000931]	-0.00143 [0.000923]
Log Assets	-0.985*** [0.0457]	-0.984*** [0.0463]	-0.973*** [0.0487]	-0.970*** [0.0484]	0.00723* [0.00431]	0.00746* [0.00430]	0.00803* [0.00419]	0.00784* [0.00421]
Log Sales	-0.0219 [0.0479]	-0.0222 [0.0478]	-0.0315 [0.0491]	-0.0343 [0.0488]	-0.0137*** [0.00494]	-0.0137*** [0.00493]	-0.0141*** [0.00488]	-0.0140*** [0.00488]
Leverage	-0.211 [0.164]	-0.202 [0.164]	-0.162 [0.166]	-0.163 [0.166]	0.0417** [0.0199]	0.0411** [0.0197]	0.0413** [0.0197]	0.0421** [0.0200]
Log Cash	0.0596** [0.0249]	0.0609** [0.0248]	0.0696*** [0.0251]	0.0701*** [0.0250]	0.00873*** [0.00207]	0.00870*** [0.00206]	0.00910*** [0.00214]	0.00915*** [0.00215]
Log Sales Growth	0.191** [0.0802]	0.191** [0.0797]	0.219*** [0.0798]	0.221*** [0.0801]	-0.00176 [0.00496]	-0.00168 [0.00497]	-0.00235 [0.00517]	-0.00241 [0.00517]
Log Market:Book	0.140** [0.0571]	0.144** [0.0572]	0.139** [0.0576]	0.135** [0.0569]	0.0173*** [0.00434]	0.0176*** [0.00441]	0.0176*** [0.00429]	0.0175*** [0.00422]
Return	-0.0205 [0.0347]	-0.0217 [0.0344]	-0.0407 [0.0298]	-0.0392 [0.0298]	-0.00552** [0.00217]	-0.00558** [0.00218]	-0.00567** [0.00229]	-0.00566** [0.00228]
Log Age	0.277 [0.237]	0.285 [0.236]	0.225 [0.237]	0.226 [0.238]	0.0198 [0.0137]	0.0204 [0.0139]	0.0203 [0.0138]	0.02 [0.0136]
Clustered s.e. at firm-hire year level	Y	Y	Y	Y	Y	Y	Y	Y
Hire Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y
Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y
SIC One Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y
Year * SIC One Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y
SIC Two Digit F.E.	N	N	N	N	N	N	N	N
Matched on Bonus Level	Y	Y	Y	Y	Y	Y	Y	Y
Observations	1,463	1,463	1,430	1,430	1,555	1,555	1,517	1,517
R-squared	0.904	0.905	0.904	0.904	0.459	0.46	0.464	0.463

Panel C	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
	Acquisition t+1				Log(volatility) t+1			
Post	0.0107 [0.00734]	0.011 [0.00739]	9.50E-03 [0.00751]	0.0088 [0.00745]	-0.0273 [0.0566]	-0.023 [0.0575]	-0.052 [0.0591]	-0.059 [0.0571]
Treatment (Hire=Corporate)	-0.0032 [0.00546]	-0.00326 [0.00542]	-0.00338 [0.00541]	-0.00335 [0.00545]	0.0404 [0.0387]	0.0403 [0.0387]	0.0406 [0.0389]	0.0403 [0.0390]
Post*Treatment	-0.0032 [0.00613]	-0.00699 [0.00652]	-0.00564 [0.00680]	-0.00152 [0.00638]	-0.0980*** [0.0363]	-0.0995** [0.0387]	-0.0684 [0.0415]	-0.0649* [0.0387]
Post*GCDelta_Hireyear		-0.0105 [0.0249]	-0.0362 [0.0831]			-0.305 [0.294]	-0.688 [0.633]	
Post*Treat*GCDelta_Hireyear		0.438** [0.176]	0.440** [0.186]			-0.0511 [0.912]	0.232 [1.005]	
Post*CEODelta_Hireyear			-0.000880* [0.000454]	-0.000862* [0.000465]			0.0389*** [0.00820]	0.0386*** [0.00828]
Post*Treat*CEODelta_Hireyear			0.00085 [0.000597]	0.000785 [0.000595]			-0.0379*** [0.00889]	-0.0378*** [0.00894]
Log Assets	-0.00302 [0.00199]	-0.00348* [0.00195]	-0.00263 [0.00195]	-0.00212 [0.00198]	-0.0689*** [0.0246]	-0.0675*** [0.0250]	-0.0692*** [0.0240]	-0.0696*** [0.0240]
Log Sales	0.000879 [0.00241]	0.000889 [0.00238]	0.000158 [0.00238]	8.56E-05 [0.00240]	-0.019 [0.0224]	-0.0192 [0.0223]	-0.0233 [0.0215]	-0.0244 [0.0217]
Leverage	-0.00977 [0.0148]	-0.00744 [0.0147]	-0.00518 [0.0149]	-0.00735 [0.0150]	0.338*** [0.100]	0.337*** [0.100]	0.352*** [0.100]	0.356*** [0.100]
Log Cash	0.00082 [0.00116]	0.00104 [0.00112]	0.00124 [0.00114]	0.00106 [0.00119]	0.0738*** [0.0119]	0.0739*** [0.0119]	0.0722*** [0.0118]	0.0726*** [0.0119]
Log Sales Growth	0.00839** [0.00414]	0.00830** [0.00411]	0.00950** [0.00421]	0.00955** [0.00424]	0.0604 [0.0432]	0.0606 [0.0432]	0.0626 [0.0423]	0.0629 [0.0423]
Log Market:Book	0.00607 [0.00441]	0.00547 [0.00422]	0.00494 [0.00423]	0.00544 [0.00442]	-0.0782** [0.0334]	-0.0763** [0.0338]	-0.0779** [0.0341]	-0.0808** [0.0337]
Return	-0.000352 [0.00291]	-0.000226 [0.00290]	0.000451 [0.00290]	0.000322 [0.00291]	0.0325* [0.0176]	0.0321* [0.0176]	0.0303* [0.0179]	0.0311* [0.0179]
Log Age	0.00376 [0.0130]	0.00269 [0.0129]	0.00204 [0.0130]	0.00303 [0.0131]	-0.181* [0.105]	-0.177* [0.106]	-0.169 [0.104]	-0.173* [0.103]
Clustered s.e. at firm-hire year level	Y	Y	Y	Y	Y	Y	Y	Y
Hire Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y
Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y
SIC One Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y
Year * SIC One Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y
SIC Two Digit F.E.	N	N	N	N	N	N	N	N
Matched on Bonus Level	Y	Y	Y	Y	Y	Y	Y	Y
Observations	1,571	1,571	1,533	1,533	1,561	1,561	1,523	1,523
R-squared	0.14	0.146	0.146	0.141	0.597	0.598	0.608	0.607

Table 7: Executive General Counsel Incentive Pay and Governance Outcome

This table presents difference in difference tests on ExecGC incentive pay and governance outcome. The treatment group is corporations hiring ExecGCs from other corporations, and the control group is firms that are matched within the year-inudstry and litigation risk and hire ExecGCs from law firms. Panel A presents baseline results while Panel B further considers two-digit SIC industry fixed effects and Panel C further considers incentive and bonus paid to ExecGC in the hire year to find matched firms. Our sample comprises firm years in ExecuComp from 1995 to 2012. Variable definitions are provided in Appendix Table 1. Standard errors are clustered at the firm level. Superscripts ***, **, * indicate statistical significance level at the 1%, 5%, and 10% level, respectively.

Panel A	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
	Class Action			Backdating				Fraud Score				
Post	-0.0275	-0.0275	-0.0273	-0.0274	-0.00546	-0.00418	-0.00501	-0.00642	-0.00152	-0.00135	-0.00146	-0.00167
	[0.0228]	[0.0226]	[0.0225]	[0.0227]	[0.0502]	[0.0504]	[0.0504]	[0.0502]	[0.105]	[0.105]	[0.106]	[0.105]
Treatment (Hire=Corporate)	0.0748*	0.0806*	0.0666*	0.0593	0.0364	0.0232	0.0339	0.0432	-0.0484	-0.0279	-0.0342	-0.0511
	[0.0408]	[0.0410]	[0.0402]	[0.0397]	[0.0826]	[0.0823]	[0.0834]	[0.0832]	[0.120]	[0.121]	[0.126]	[0.125]
Post*Treatment	-0.00435	-0.0236	-0.0134	0.0123	-0.0581	-0.0739	-0.0715	-0.0571	-0.0664	-0.128	-0.0963	-0.0427
	[0.0305]	[0.0294]	[0.0287]	[0.0323]	[0.0645]	[0.0647]	[0.0649]	[0.0664]	[0.112]	[0.113]	[0.126]	[0.122]
Post*GCDelta_Hireyear		-0.496***	-0.964***			0.0844	-0.466			-1.306**	-1.47	
		[0.177]	[0.359]			[0.224]	[0.558]			[0.558]	[1.264]	
Post*Treat*GCDelta_Hireyear		0.372	0.661*			4.350*	5.017**			5.970***	6.030***	
		[0.317]	[0.393]			[2.288]	[2.345]			[1.751]	[2.077]	
Post*CEODelta_Hireyear			0.0133	0.0111			0.00316	0.00268			-0.00723	-0.0116
			[0.00866]	[0.00970]			[0.0125]	[0.0124]			[0.0135]	[0.0158]
Post*Treat*CEODelta_Hireyear			-0.00414	-0.00829			-0.0141	-0.00998			-0.024	-0.0172
			[0.00905]	[0.0117]			[0.0134]	[0.0130]			[0.0157]	[0.0179]
Clustered s.e. at firm-hire year level	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Hire Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
SIC One Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Year * SIC One Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
SIC Two Digit F.E.	N	N	N	N	N	N	N	N	N	N	N	N
Matched on Bonus Level	N	N	N	N	N	N	N	N	N	N	N	N
Observations	1,969	1,966	1,917	1,920	900	897	874	877	1,964	1,961	1,912	1,915
R-squared	0.103	0.099	0.101	0.103	0.175	0.179	0.189	0.183	0.173	0.178	0.182	0.177

Panel A	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)
	Manipulation Score				AAER Fraud			
Post	0.15 [0.0928]	0.15 [0.0929]	0.149 [0.0932]	0.149 [0.0931]	-0.00989 [0.0231]	-0.00989 [0.0231]	-0.00986 [0.0231]	-0.00987 [0.0231]
Treatment (Hire=Corporate)	-0.0268 [0.153]	-0.0453 [0.152]	0.0014 [0.160]	0.00908 [0.164]	0.0113 [0.0418]	0.0138 [0.0420]	0.0127 [0.0412]	0.011 [0.0410]
Post*Treatment	-0.112 [0.131]	-0.189 [0.140]	-0.19 [0.142]	-0.0929 [0.131]	-0.0206 [0.0253]	-0.0213 [0.0258]	-0.0173 [0.0269]	-0.0183 [0.0259]
Post*GCDelta_Hireyear		-0.353 [0.884]	-1.429 [1.740]			-0.183* [0.0981]	-0.268 [0.188]	
Post*Treat*GCDelta_Hireyear		5.538** [2.651]	6.174** [3.055]			0.034 [0.286]	0.0879 [0.307]	
Post*CEODelta_Hireyear			-0.0248 [0.0319]	-0.0268 [0.0298]			-0.00299 [0.00232]	-0.00355 [0.00227]
Post*Treat*CEODelta_Hireyear			0.0206 [0.0326]	0.00931 [0.0340]			0.000677 [0.00329]	0.00161 [0.00301]
Clustered s.e. at firm-hire year level	Y	Y	Y	Y	Y	Y	Y	Y
Hire Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y
Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y
SIC One Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y
Year * SIC One Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y
SIC Two Digit F.E.	N	N	N	N	N	N	N	N
Matched on Bonus Level	N	N	N	N	N	N	N	N
Observations	1,907	1,904	1,855	1,858	1,526	1,523	1,477	1,480
R-squared	0.131	0.13	0.132	0.134	0.098	0.098	0.093	0.092

Panel B	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
	Class Action			Backdating				Fraud Score				
Post	-0.0289	-0.0313	-0.029	-0.0274	0.0075	0.00705	0.00445	0.00471	-0.000598	-0.00213	-0.000307	0.00211
	[0.0236]	[0.0232]	[0.0228]	[0.0233]	[0.0561]	[0.0564]	[0.0563]	[0.0564]	[0.0951]	[0.0947]	[0.0952]	[0.0958]
Treatment (Hire=Corporate)	0.0696*	0.0746*	0.0585	0.0523	0.0622	0.0521	0.0658	0.0709	-0.0224	-0.0307	-0.037	-0.034
	[0.0403]	[0.0406]	[0.0397]	[0.0390]	[0.0844]	[0.0838]	[0.0841]	[0.0851]	[0.120]	[0.122]	[0.127]	[0.125]
Post*Treatment	-0.000939	-0.0221	-0.0126	0.0131	-0.058	-0.0735	-0.0701	-0.0503	-0.0574	-0.0808	-0.0734	-0.0459
	[0.0310]	[0.0305]	[0.0296]	[0.0324]	[0.0686]	[0.0688]	[0.0689]	[0.0704]	[0.113]	[0.116]	[0.128]	[0.122]
Post*GCDelta_Hireyear		-0.577***	-0.957***			0.0599	-0.992			0.609	0.42	
		[0.214]	[0.361]			[0.268]	[0.824]			[0.528]	[0.931]	
Post*Treat*GCDelta_Hireyear		0.539	0.760*			3.525	4.775*			3.449**	3.527*	
		[0.373]	[0.433]			[2.392]	[2.467]			[1.692]	[1.881]	
Post*CEODelta_Hireyear			0.0149	0.0135			0.00221	0.00181			-0.0022	-0.00165
			[0.00938]	[0.0101]			[0.00963]	[0.00956]			[0.0129]	[0.0128]
Post*Treat*CEODelta_Hireyear			-0.0024	-0.00561			-0.0182	-0.0157			-0.000123	0.00191
			[0.00926]	[0.0113]			[0.0126]	[0.0132]			[0.0223]	[0.0193]
Clustered s.e. at firm-hire year level	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Hire Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
SIC One Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Year * SIC One Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
SIC Two Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Matched on Bonus Level	N	N	N	N	N	N	N	N	N	N	N	N
Observations	1,969	1,966	1,917	1,920	900	897	874	877	1,964	1,961	1,912	1,915
R-squared	0.148	0.141	0.146	0.15	0.224	0.225	0.238	0.235	0.275	0.279	0.282	0.278

Panel B	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)
	Manipulation Score				AAER Fraud			
Post	0.141	0.134	0.133	0.14	-0.0138	-0.0139	-0.0139	-0.0138
	[0.0936]	[0.0934]	[0.0940]	[0.0943]	[0.0233]	[0.0233]	[0.0233]	[0.0233]
Treatment (Hire=Corporate)	0.000134	-0.0238	0.0281	0.0378	0.0108	0.0114	0.0104	0.0106
	[0.157]	[0.158]	[0.166]	[0.167]	[0.0401]	[0.0404]	[0.0395]	[0.0391]
Post*Treatment	-0.12	-0.183	-0.192	-0.11	-0.0247	-0.0261	-0.0246	-0.0244
	[0.134]	[0.141]	[0.141]	[0.134]	[0.0255]	[0.0263]	[0.0273]	[0.0263]
Post*GCDelta_Hireyear		-0.0989	-1.343			-0.0678	0.0111	
		[0.978]	[1.784]			[0.0724]	[0.278]	
Post*Treat*GCDelta_Hireyear		5.183*	6.008*			0.255	0.148	
		[2.743]	[3.058]			[0.391]	[0.458]	
Post*CEODelta_Hireyear			-0.0267	-0.0288			-0.00398	-0.00398
			[0.0290]	[0.0275]			[0.00248]	[0.00243]
Post*Treat*CEODelta_Hireyear			0.0217	0.0171			0.00348	0.00358
			[0.0328]	[0.0313]			[0.00314]	[0.00297]
Clustered s.e. at firm-hire year level	Y	Y	Y	Y	Y	Y	Y	Y
Hire Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y
Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y
SIC One Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y
Year * SIC One Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y
SIC Two Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y
Matched on Bonus Level	N	N	N	N	N	N	N	N
Observations	1,907	1,904	1,855	1,858	1,526	1,523	1,477	1,480
R-squared	0.168	0.165	0.168	0.172	0.158	0.158	0.153	0.153

Panel C	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
	Class Action				Backdating				Fraud Score			
Post	-0.0530**	-0.0549**	-0.0502**	-0.0500**	0.0123	0.00996	0.000464	0.00226	-0.054	-0.0578	-0.0581	-0.0531
	[0.0232]	[0.0232]	[0.0225]	[0.0225]	[0.0641]	[0.0648]	[0.0630]	[0.0629]	[0.0761]	[0.0765]	[0.0791]	[0.0789]
Treatment (Hire=Corporate)	0.0497	0.0588	0.0468	0.0378	-0.0248	-0.0344	-0.0273	-0.0284	-0.0295	-0.0313	-0.0154	-0.0169
	[0.0428]	[0.0433]	[0.0428]	[0.0417]	[0.0941]	[0.0944]	[0.0939]	[0.0937]	[0.117]	[0.119]	[0.121]	[0.117]
Post*Treatment	-0.0123	-0.0263	-0.0234	-0.00932	-0.0395	-0.0624	-0.0479	-0.0136	-0.049	-0.0748	-0.0776	-0.0478
	[0.0279]	[0.0291]	[0.0288]	[0.0270]	[0.0756]	[0.0748]	[0.0710]	[0.0720]	[0.0822]	[0.0849]	[0.0947]	[0.0909]
Post*GCDElta_Hireyear		-0.613***	-0.808**			0.126	-1.194			0.371	0.272	
		[0.172]	[0.370]			[0.294]	[0.997]			[0.490]	[1.062]	
Post*Treat*GCDElta_Hireyear		1.139***	1.313**			5.831***	7.249***			3.212**	3.304*	
		[0.401]	[0.507]			[2.161]	[2.154]			[1.608]	[1.801]	
Post*CEODElta_Hireyear			0.0152*	0.0148			-0.00118	-0.0019			-0.0104	-0.0104
			[0.00893]	[0.00924]			[0.0114]	[0.0115]			[0.0132]	[0.0132]
Post*Treat*CEODElta_Hireyear			-0.00188	-0.00167			-0.0204	-0.0194			0.00611	0.00625
			[0.00934]	[0.00964]			[0.0136]	[0.0140]			[0.0215]	[0.0214]
Clustered s.e. at firm-hire year level	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Hire Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
SIC One Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Year * SIC One Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
SIC Two Digit F.E.	N	N	N	N	N	N	N	N	N	N	N	N
Matched on Bonus Level	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	1,674	1,674	1,632	1,632	751	751	732	732	1,670	1,670	1,628	1,628
R-squared	0.193	0.198	0.195	0.192	0.244	0.25	0.273	0.266	0.298	0.3	0.302	0.301

Panel C	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)
	Manipulation Score				AAER Fraud			
Post	0.0547 [0.0895]	0.0494 [0.0898]	0.0563 [0.0899]	0.0594 [0.0899]	-0.0221 [0.0223]	-0.0225 [0.0224]	-0.0216 [0.0227]	-0.0214 [0.0227]
Treatment (Hire=Corporate)	0.0763 [0.175]	0.0831 [0.175]	0.167 [0.185]	0.129 [0.187]	0.0196 [0.0432]	0.0204 [0.0435]	0.0227 [0.0422]	0.0222 [0.0417]
Post*Treatment	-0.0288 [0.133]	-0.0648 [0.142]	-0.14 [0.133]	-0.0705 [0.126]	-0.0237 [0.0247]	-0.0261 [0.0253]	-0.0313 [0.0263]	-0.0293 [0.0257]
Post*GCDelta_Hireyear		-0.274 [1.088]	-3.454* [1.995]			-0.0875 [0.0769]	-0.102 [0.362]	
Post*Treat*GCDelta_Hireyear		3.915 [3.378]	6.780* [3.657]			0.47 [0.556]	0.469 [0.656]	
Post*CEODelta_Hireyear			-0.0325 [0.0308]	-0.0339 [0.0310]			-0.00521* [0.00271]	-0.00524* [0.00272]
Post*Treat*CEODelta_Hireyear			0.0385 [0.0344]	0.0395 [0.0345]			0.00640* [0.00335]	0.00644* [0.00334]
Clustered s.e. at firm-hire year level	Y	Y	Y	Y	Y	Y	Y	Y
Hire Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y
Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y
SIC One Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y
Year * SIC One Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y
SIC Two Digit F.E.	N	N	N	N	N	N	N	N
Matched on Bonus Level	Y	Y	Y	Y	Y	Y	Y	Y
Observations	1,623	1,623	1,581	1,581	1,288	1,288	1,249	1,249
R-squared	0.187	0.188	0.192	0.19	0.195	0.195	0.189	0.189

Table 8: Summary of Governance Improvement and Unwinding by Equity Incentives

This table presents the summary on governance improvement and unwinding for a standard deviation change in ExecGC delta in the hiring year. The value of governance improvement is taken from Table 3 Panel A and the value of unwinding is taken from Table 7 Panel C. The denominator for the percentage change is the mean of two pre-hiring years for the external hiring sample. Unwinding as a percentage of governance improvement is the ratio of column (4) to column (2), multiplied by 100.

	Governance improvement		Unwind given one sd change in ExecGC delta		
	(1)	(2)	(3)	(4)	(5)
	Value	% of mean	Value	% of mean	As % of governance improvement
Class Action	-0.0112	-20.40%	0.0074	13.57%	66.48%
Backdating	.	.	0.0410	12.50%	.
Fraud Score	-0.1155	-9.06%	0.0187	1.46%	16.16%
Manipulation Score	-0.1063	-4.40%	0.0383	1.59%	36.04%
AAER Fraud	-0.0175	-36.90%	.	.	.

Appendix Table 1: Variable Definition, Data Sources and Descriptive Statistics

This table presents the definition and sources of the variables used in the study and shows the summary statistics of the variables.

Variable name	Variable definition	Sources	N	Mean	Median	Std
<u>ExecGC Background</u>						
ExecGC	Indicator variable equal to one if a general counsel appears in ExecuComp as one of the top paid executives.	Execucomp	32,610	0.391	0	0.488
Secretary	Indicator variable equal to one if a general counsel is also the corporate secretary, and zero otherwise.	Execucomp, Def 14As and 10-Ks	12,764	0.560	1	0.496
Director	Indicator variable equal to one if a general counsel is also a director on the board, and zero otherwise.	Execucomp, Def 14As and 10-Ks	12,764	0.040	0	0.196
Femdem	Indicator variable equal to one if a general counsel is female, and zero otherwise.	Execucomp, Def 14As and 10-Ks	12,764	0.126	0	0.332
Age	The age of the ExecGC	Execucomp, Def 14As and 10-Ks	12,616	50.871	51	7.289
<i>(The statistics below are based on unique ExecGC-Firm observations where the immediate job experience prior to GC is available)</i>						
Internal	ExecGC was internally promoted	Execucomp, Def 14As and 10-Ks	2,601	0.274	0	0.446
External-Law Firms	Indicator variable equal to one if an ExecGC was hired directly from a law firm.	Def 14As, 10-Ks, Matindale-Hubbard, LinkedIn, online searches	2,601	0.271	0	0.445
External-Top Law Firms	Indicator variable equal to one if an ExecGC was hired directly from a top law firm (according to the AmLaw 100 list).	Def 14As, 10-Ks, Matindale-Hubbard, LinkedIn, online searches, American Lawyer	2,601	0.123	0	0.329
External-Government Officials	Indicator variable equal to one if an ExecGC held important government positions (e.g. Attorney General, White House Counsel, Judge, Federal Attorney, Department of Justice etc.) before becoming a GC.	Def 14As, 10-Ks, Matindale-Hubbard, LinkedIn, online searches	2,601	0.007	0	0.081
External-Corp.	Indicator variable equal to one if an ExecGC was hired directly from another corporation	Def 14As, 10-Ks, Matindale-Hubbard, LinkedIn, online searches	2,601	0.444	0	0.497
External-Corp. GC	Indicator variable equal to one if an ExecGC was hired directly from another corporation where the ExecGC was the GC	Def 14As, 10-Ks, Matindale-Hubbard, LinkedIn, online searches	2,601	0.237	0	0.425
<u>Compensation</u>						
GC Pay	ExecGC total compensation (salary, bonus, other cash compensation, option grants, and restricted stocks) in constant 2012 dollars.	Execucomp	12,764	1,379	766	3,575
GC Pay rank	Actual total pay rank of the ExecGC among top paid executives.	Execucomp	12,764	4.503	4.000	1.479
CEO Pay	CEO total compensation (salary, bonus, other cash compensation, option grants, and restricted stocks) in constant 2012 dollars.	Execucomp	12,236	6,252	2,891	24,671
GC pay / CEO pay	Total compensation of the ExecGC to the total compensation of the CEO.	Execucomp	12,207	0.378	0.301	0.378
GC Cashpay	Salary plus bonus	Execucomp	12,764	540	427	434
GC Grants	Total value of option grants (valued by Black-Scholes) and restricted stocks in constant 2012 dollars..	Execucomp	12,764	757	242	3,409
Grants/pay	ExecGC's grants scaled by total pay.	Execucomp	12,764	0.341	0.342	0.283
GC Delta	Total wealth for performance sensitivities (delta measure) based on stock holdings and unexercised options in constant 2012 (thousand) dollars based on Core and Guay (1999).	Execucomp	12,415	0.050	0.018	0.112
CEO Delta	CEO's total wealth for performance sensitivities (delta measure) based on stock holdings and unexercised options in constant 2012 (thousand) dollars based on Core and Guay (1999).	Execucomp	11,771	0.471	0.191	0.727

Accounting Manipulation, Fraud, Class Action, and Option Backdating

Class Action	Indicator equal to one for fiscal years coinciding the class period identified by the securities class action lawsuits, and zero otherwise. Dismissed cases are dropped for defining this variable.	Stanford Law School Securities Class Action Clearing House	32,610	0.029	0.000	0.168
Backdating	Indicator equals to one if the stock return reversal deflated by stock volatility around the option grant date is greater than 75 percentile of the deflated reversals in Thomson database. Return reversal is calculated as return of the 20 days after the grant date minus the return of 20 days before the grant date. This variable is set equal to missing for fiscal years after 2008.	Thomson Reuters Insider Data	12,198	0.294	0.000	0.455
Fraud Score	The firm's probability of fraud based on the fraud model of Dechow et al. (2011) divided by the unconditional probability of fraud. We calculate predicted probability using the coefficient estimates from Dechow et al. (2011). Predicted Value= $-7.893+0.79*rsst_acc+2.518*ch_rec+1.191*ch_inv+1.979*soft_assets+0.171*ch_cs+(-0.932)*ch_roa+1.029*issue$. RSST accruals come from Richardson, Sloan, Soliman, and Tuna 2005. This measure extends the definition of WC accruals to include changes in long-term operating assets and long-term operating liabilities. $WC=(Current\ Assets-Cash\ and\ Short-term\ Investments)-(Current\ Liab - Debt\ in\ Current\ Liab)$; $NCO=(Total\ Assets - Current\ Assets - Investments\ and\ Advances) - (Total\ Liab - Current\ Liab - LT\ Debt)$; $FIN=(ST\ Investments + LT\ Investment) - (LT\ Debt + Debt\ in\ Current\ Liab + Preferred\ Stock)$; Chg in Receivables is defined as $chg\ in\ AR/Average\ Total\ Assets$; Chg in Inventory is $chg\ in\ Inventory/Average\ Total\ Assets$; % Soft Assets = $[Total\ Assets - PPE - Cash\ and\ Cash\ Equivalent]/Total\ Assets$; Chg in cash sales is $Pct\ chg\ in\ cash\ sales, cash\ sales=[Sales - Chg\ in\ AR]$; Chg in ROA is $Earnings_t/Average\ total\ asset_t - Earnings_t-1/Average\ total\ asset_t-1$; Issue is an indicator variable equal to 1 if the firm issued securities.	Center for Financial Reporting and Management Center at the Haas School of Business, Compustat	32,234	1.161	0.976	1.024
Manipulation Score	Beneish M Score = $-4.84+0.920*dsr+0.528*gmi+0.404*aqi+0.892*sgi+0.115*depi-0.172*sgai+4.679*taccr-0.327*levi$; where dsr is "Days Sales in Receivables", gmi is "Gross Margin Index", aqi is "Asset Quality Index", sgi is "Sales Growth Index", depi is "Depreciation Index", sgai is "Sales, General and Administrative expenses Index", taccr is "Total Accruals to total assets", and levi is "Leverage Index".	Compustat	31,611	-2.504	-2.568	1.212
AAER Fraud	Indicator equal to one if the financial statements of a given fiscal year is restated and investigated by the SEC, zero otherwise. Accounting and Auditing Enforcement Releases are issued by the SEC during or at the conclusion of an investigation against a company, an auditor, or an officer for alleged accounting and/or auditing misconduct. This variable is set equal to missing for fiscal years after 2008.	Center for Financial Reporting and Management Center at the Haas School of Business	24,142	0.023	0.000	0.149

Determinants of Litigation Risks – Kim and Skinner (2012) Model

FPS	Indicator variable equal to one if the firm is in the biotech (SIC codes 2833-2836 and 8731-8734), computer (3570-3577 and 7370-7374), electronics (3600-3674), or retail (5200-5961) industry, and zero otherwise	Compustat	32,610	0.280	0.000	0.449
Sales	Sales in millions of constant 2012 dollars.	Compustat	32,597	5,992	1,415	18,256
Salegrowth	Sales in the current year scaled by the average sales of last three years, minus one.	Compustat	31,421	0.273	0.167	0.567

Return	Annual cumulative stock returns minus cumulative market (CRSP value weighted) returns over the fiscal year.	CRSP	31,950	0.079	-0.006	0.680
Volatility	Annualized standard deviation of daily stock returns over the fiscal year.	CRSP	31,833	0.450	0.390	0.243
Skewness	Skewness of daily stock returns over the fiscal year.	CRSP	31,949	0.213	0.210	0.935
Liquidity	Average daily stock turnover over the fiscal year.	CRSP	31,951	0.890	0.658	0.770
Prob_sued	Predicted probability of being litigated based on the coefficient estimates from the logit regression on the determinants of litigation risk (following Kim and Skinner (2012)).	Compustat and CRSP	28,892	0.019	0.012	0.020
<u>Investment measures</u>						
Investment_intensity	Capital expenditure to PP&E	Compustat	31,398	0.001	0.000	0.010
R&D	R&D expenses to assets	Compustat	32,308	0.042	0.014	0.074
Acquisition	Acquisition scaled by assets	Compustat	32,610	0.024	0.000	0.058
Other Characteristics						
Age	Number of years since a firm first appears on CRSP (use the median of the sample if missing).	CRSP	32,610	50.212	50.000	6.242
Mktbk	Market value of assets (market value of common equity plus book value of preferred equity, plus book value of total debt minus deferred taxes) to book assets.	Compustat	32,116	1.633	1.140	2.131
Leverage	Total liabilities to assets	Compustat	32,522	0.566	0.559	0.289
Cash	Cash balance to book assets.	Compustat	32,602	0.143	0.071	0.173
Institutional ownpct	Percentage of institutional ownership from 13F filings	Thomson Reuters Ownership Database	32,573	0.583	0.662	0.319
Institutional ownpct HHI	HHI concentration ratio of insitutional ownership.	Thomson Reuters Ownership Database	32,573	0.062	0.043	0.099
Blockholder	Indicator variable equal to one if there is at least one institutional investor with at least 5% ownership.	Thomson Reuters Ownership Database	32,573	0.726	1.000	0.446
Board independence	Percentage of independent directors on board	Riskmetrics	25,024	69.292	71.429	16.914
Board size	Number of directors on the board	Riskmetrics	25,024	9.488	9.000	2.779
Governance Index	Gompers, Ishii and Metrick (2003) governance index	Riskmetrics	17,663	9.226	9.000	2.648

Appendix Table 2: Estimation of Litigation Risk

This logit model is estimated for all Compustat/CRSP firms during 1995-2012. Dependent variable equals one if there is class action law suits against a firm in a given year. Variable definitions are provided in Appendix Table 1.

	(1)
	Dependent = Sued
FPS	0.5356*** -0.0790
Size	0.4632*** -0.0220
Salegrowth	0.2290*** -0.0320
Return	0.0015 -0.0460
Volatility	0.3149** -0.1370
Skewness	-0.2597*** -0.0450
Liquidity	0.0002*** 0.0000
Constant	-8.4181*** -0.198
Observations	86,062
Pesudo R squared	0.132

Appendix Table 3: List of Top 20 AMLaw 100 law firms our sample ExecGCs were hired from

Law Firm Name	HQ State	HQ City	Number of ExecGCs
O Melveny & Myers	CA	Los Angeles	14
Latham & Watkins	CA	Los Angeles	10
Jones Day	DC	Washington	8
Sidley & Austin	NY	New York	8
Winston & Strawn	IL	Chicago	8
Alston & Bird	GA	Atlanta	7
Gibson, Dunn & Crutcher	CA	Los Angeles	7
Hunton & Williams	VA	Richmond	7
Jenner & Block	IL	Chicago	7
Pillsbury Winthrop Shaw Pittman	NY	New York	7
Skadden, Arps, Slate, Meagher & Flom	NY	New York	7
Vinson & Elkins	TX	Houston	7
Baker & Botts	TX	Houston	6
LeBoeuf, Lamb, Greene & MacRae	UT	Salt Lake City	6
Pepper Hamilton	DE	Wilmington	6
Troutman Sanders	GA	Atlanta	6
Brobeck, Phleger & Harrison	CA	San Francisco	5
Fulbright & Jaworski	TX	Houston	5
Foley & Lardner	WI	Milwaukee	5
Morris James	DE	Wilmington	5
Perkins Coie	WA	Seattle	5