Faculti Summary
https://staging.faculti.net/managerial-litigation-risk/

The study investigates the impact of changes in managerial litigation risk, particularly due to the adoption of universal demand (UD) laws in certain U.S. states. These laws significantly restrict shareholders' ability to file derivative lawsuits against managers by requiring board approval, which diminishes managerial litigation risk.

The research aims to understand how this reduction affects capital investment decisions by managers, particularly concerning investment efficiency—essentially, whether managers are effectively allocating resources to projects. The hypotheses suggest that after the adoption of UD laws, firms may experience increased underinvestment (where managers avoid investing in profitable projects) and overinvestment (where they invest in value-diminishing projects).

The findings indicate that firms in states with UD laws show a significant decrease in investment efficiency post-adoption, with evidence of increased underinvestment and overinvestment depending on the firm's circumstances. This video video reduced efficiency is linked to managers taking on excessive risk, as they feel less constrained by the threat of litigation.

Ultimately, the study contributes to existing literature by highlighting the unintended negative consequences of legislation intended to protect managers, showing that such protection can harm shareholder wealth by resulting in inefficient investment decisions. The results underscore the importance of regulatory frameworks in influencing corporate governance and investment practices.