Guest editorial

Introduction to the special issue on legal issues and litigation in modern corporate finance

We are pleased to introduce this special issue on legal issues and litigation in modern corporate finance. Not only this is the first time that *Managerial Finance* has elected to dedicate an entire issue to corporate litigation, it is the first time that any academic finance journal has focused exclusively on this topic. Research on litigation in corporate finance has proliferated over the last decade as corporations have experienced record levels of lawsuits and legal action. Given the volume of scholarship that is now emerging on litigation, we felt that the time was appropriate for a special issue on this topic. As the article selection in this volume shows, the effect of litigation on businesses is both multi-faceted and pervasive. This volume of *Managerial Finance,* in addition to a literature survey, includes seven articles that focus on the relation between litigation and various aspects of corporate decision making such as operating performance, litigation risk management, governance, merger and acquisition, taxation, and insider trading.

Because of the volume of academic studies examining corporate litigation, we believe that the researcher can benefit from a review of the extant literature on this subject. Therefore, we decided to begin the issue with a survey of the academic literature on the financial effects of corporate litigation. Arena and Ferris (2016) is the first such survey and reviews the litigation research from the first event studies on lawsuit filings to the most recent analysis examining the effect of alternate corporate governance structures or political connectivity. Arena and Ferris first survey studies that estimate litigation risk and then follow with a review of litigation costs, the announcement effect of lawsuits, the relation between litigation and a variety of corporate policies, and the influence of corporate political connections on litigation outcomes. Their survey concludes with a brief discussion of promising areas for future research involving corporate litigation. The following research papers in this issue examine how litigation affects various corporate decisions and behaviors that are described in the survey.

Amoozegar *et al.* (2016) analyze the importance of the chief risk officer and the risk committee to reduce litigation risk for financial institutions. Their study is very timely as financial institutions have experienced a high incidence of lawsuits following the 2007-2008 financial crisis. Through a principal component analysis, the authors find that a strong risk management department significantly decreases litigation risk. This reduction in risk subsequently improves a bank's performance.

Operating performance is the main focus of the third study in this issue. Diaz-Rainey and McCarten (2016) analyze a firm's operating performance both pre- and post-litigation. They find that a firm's performance starts to deteriorate three years prior to a lawsuit which is much earlier than previously believed. The lawsuit filing marks a turning point for the company's profitability. Most firms take corrective actions in their financing and investing choices following a lawsuit. These corrections appear to allow the firm to improve its performance.

The fourth study included in this issue is by Lenard *et al.* (2016). It contributes to the growing literature on behavioral factors affecting litigation. The authors find that companies led by female executives or with boards that include female directors are characterized by lower litigation risk. The risk-averse propensity of female directors reduces the probability of a lawsuit, especially if these directors are members of the audit committee.

Boulton and Nixon (2016) show how a court ruling following a lawsuit can have a significant effect on the stock market's reaction to corporate financial decisions. Specifically, they find that following the ruling of *Selectica, Inc. v. Versata Enterprises, Inc. and Trilogy, Inc.*

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firms that previously adopted tax benefit preservation plans and even potential plan adopters experience a significant decline in their stock price.

Croci *et al.* (2016) discover that when minority shareholders file a lawsuit following an M&A deal in which they are "squeezed out" (i.e. majority shareholders buy their minority stake in the company) to challenge the cash amount received, they successfully receive additional compensation. The authors show that the litigation outcome differ significantly, depending on the type of litigation (i.e. appraisals vs actions of avoidance).

The last two studies included in this special issue focus on two different aspects of the relation between litigation and insider trading. Davis *et al.* (2016) find that corporate insiders, especially managing insiders, opportunistically trade prior not only to lawsuit filings but as well to settlement announcements. In both situations, they gain abnormal returns. Lim and Wasiuzzaman (2016) analyze the effectiveness of institutional monitoring as a substitute for litigation in curbing insider trading in Malaysia. Their results suggest that litigation cannot be easily substituted by institutional monitoring since institutional investors actually exacerbate insider trading problems.

We want to conclude this preview of the special issue by expressing our appreciation to the authors of these studies. We thank them for submitting their insightful and useful studies for inclusion in this litigation focused issue of *Managerial Finance*. We want to thank Valerie Robillard, the Publisher, for her advice and valuable assistance during the editing process. Finally, we want to thank Dan Johnson, the Editor, for his editorial help and for the opportunity to serve as guest editors for this issue and the chance to highlight an area of corporate finance that we believe is full of promise for aspiring researchers.

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