

Distracted Institutions: The Unintended Governance Consequences of Regulatory Oversight

ABSTRACT

This paper investigates the impact of regulatory oversight on institutional investors' ability to act as stewards of their portfolio firms. We show that institutional investors distracted by regulatory investigations exhibit lower trading activities. Furthermore, firms with a larger share of distracted investors are more likely to decrease dividends, engage in value-destroying acquisitions, increase CEO compensation, grant more options to CEOs, and decrease firm' investment and R&D. Relative to other institutions, distracted institutional investors are less likely to exit the firms following these value-destroying actions, suggesting that regulatory scrutiny diverts their attention from value-relevant information about their portfolio holdings. While regulatory efforts to monitor financial intermediaries are crucial for promoting market fairness and systemic stability, our results show that such oversight may inadvertently weaken their capacity to serve as effective monitors of corporate behavior.

Keywords: Institutional investors; disciplinary history; regulatory oversight; distracted institutional investors;

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1. Introduction

Institutional investors play an important role as external monitors and disciplinarians of corporate governance, either through active oversight or by trading their holdings, to align managers' decisions with shareholder interests.¹ However, as Hirshleifer and Teoh (2003) demonstrate, investors cannot process all available information simultaneously, making attention a valuable and constrained resource in financial decision-making. Building on the idea of limited attention, recent studies demonstrate that events related to a part of an institutional investor's portfolio that attracts its attention also divert attention away from other portfolio holdings and examine the effect of such distraction on portfolio firms' actions.² Yet, portfolio shocks are not the only events that consume institutional investors' attention. Institutional investors are subject to regulatory oversight; they are monitored by various government agencies such as by the Securities and Exchange Commission (SEC) and occasionally face disciplinary actions. When an institutional investor becomes the focus of government oversight, through a regulatory investigation or enforcement action, a significant portion of its resources and attention is allocated to this interaction. This organization-wide distraction, therefore, may impair its capacity to properly monitor its portfolio firms and, consequently, impact their role in corporate governance. This paper aims to examine a novel and crucial question: What are the unintended governance consequences when the monitors themselves are being monitored?

Specifically, we investigate how regulatory oversight of institutional investors affects their stewardship role in corporate governance. We ask whether regulatory scrutiny of institutions, while necessary for market integrity, distracts them from effectively monitoring the firms in which they are invested, creating governance spillovers in their portfolio companies. This question is important. On one hand, the role of the SEC in the financial system is crucial and undisputable as it “*protects investors from misconduct, promotes fairness and efficiency in the securities markets*”³. On the other hand, the collective influence of institutional investors in corporate governance and their attention is essential in mitigating the agency problem. Hence, the potential financial and reputational consequences of

¹ Existing studies find institutional investors influence executive compensation (Hartzell & Starks, 2003), R&D investments (Aghion et. al., 2012), seasoned equity offerings (Chemmanur et. al., 2009), mergers and acquisitions (Gaspar et al, 2005), earnings management (Chung et al, 2002), payout policy (Crane et al. 2016), and CEO turnover (Helwege et. al., 2012), among others.

² Kempf et. al. (2017) capture institutional distraction in a firm as industry-level shocks to other firms in their portfolio. Ward et al. (2018) use a firm's weight in an institution's portfolio to capture their attention in the stock. Schmidt (2019) measures institutional distraction as the fraction of portfolio stocks that have an earnings announcement. These studies show that distracted institutions temporarily reduce their monitoring activities, which in turn has a negative impact on their corporate governance duties in their investee firms.

³ From the SEC website: www.sec.gov.

regulatory scrutiny may prompt institutional investors to divert attention and resources away from their governance activities. Inadvertently, this would create an attention deficit that reduces the institution's capacity to engage in active governance. Hence, understanding whether and how regulatory oversight affects institutions' attention and, in turn, their monitoring effectiveness provides valuable insights into the unintended costs of government oversight. It also raises questions about how regulatory oversight can be designed to uphold accountability in financial markets while minimizing negative spillovers on corporate governance.

To examine these questions, we develop a simple measure of regulatory distraction that relies on institutional investors' disciplinary interaction with regulatory bodies. Registered investment advisors, which account for more than 70% of 13(f) filers, are required by the SEC to disclose detailed information about their company's business operations in their Form ADV.⁴ This includes the disclosure of any criminal, regulatory, or civil judicial action related to investments or investment-related businesses that have occurred within the last ten years. Of particular relevance to our study are the initiation and resolution dates of such disciplinary actions in Form ADV. We use this information to construct our measure of institutional distraction, classifying an institution as distracted between the initiation and resolution of a disciplinary event.

Our measure of shareholders' distraction offers multiple advantages. First, it is directly observable for each individual institution. Second, the regulatory scrutiny serves as an exogenous shock to institutional investor attention, since it stems from factors unrelated to characteristics of the firms in their investment portfolios. This is in contrast to portfolio-related measures of attention such as portfolio weights (Ward et al.; 2018), fraction of holdings with earnings announcements (Schmidt; 2019), and industry-level performance (Kempt et al.; 2017). Third, disciplinary action against an institutional investor is unrelated to other economic conditions and is idiosyncratic to the institution, offering cross-sectional variation as well as temporal variation.

We hypothesize that this *exogenous* shock to institutions' attention distracts them from their portfolio holdings, which in turn may reduce their effectiveness to prevent value-destroying managerial decisions in the firms they hold. If strong shareholder monitoring and governance act as a constraint on managerial discretion, then a reduction in the intensity or effectiveness of such monitoring is expected to increase the likelihood of firm decisions that favor managerial self-interest

⁴ See Bhandari et al. (2023) for more details.

at the expense of shareholder value.⁵ Our findings are consistent with the hypothesis that disciplinary actions against institutional investors have unintended spillover effects on their portfolio holdings. We find that firms with higher distracted institutional ownership are significantly more likely to engage in value-destroying activities, indicating weakened external governance and increased managerial opportunism in the absence of institutional oversight. Specifically, we show that firms with distracted institutional shareholders are more likely to decrease or suspend dividend payouts, are more likely to announce value-destroying acquisitions, pay higher CEO compensation, and reduce capital expenditure and R&D investment—actions that undermine long-term value creation.

Research suggests that following such value-reducing corporate decisions, institutional investors, as sophisticated and informed monitors, respond by “voting with their feet,” that is, reducing or exiting their positions in the firm. We find that following these adverse outcomes, distracted institutional investors are less likely to reduce or exit their positions in these underperforming firms. Such findings are consistent with our hypothesis that, while temporarily distracted due to ongoing disciplinary actions, institutions lose, at least partially, their monitoring capacity and thus tend to respond less effectively to management value-reducing events compared to their undistracted counterparts. Together, these results highlight that although government scrutiny of institutional investor is an important component of market fairness and efficiency, such actions interfere with one of these institutions’ positive roles in the market, their corporate governance monitoring. This has significant consequences for firm behavior and long-term value.

This paper contributes to several strands of literature. First, our study builds on research examining the limits of institutional investor attention, providing new evidence that external regulatory demands can exacerbate these limitations, albeit unintendedly. Kempf et al. (2017) capture institutional distraction in a firm as industry-level shocks to other firms in their portfolio. Ward et al. (2018) use a firm’s weight in an institution’s portfolio to capture their attention. Schmidt (2019) measures institutional distraction as the fraction of portfolio stocks that have an earnings announcement. These studies show that distracted institutions temporarily reduce their monitoring activities, which in turn has a negative impact on their corporate governance duties in their investee firms. Our approach differs in both scope and mechanism. Specifically, whereas the existing measures that are the result of

⁵ Several studies, show that distracted institutions temporarily reduce their monitoring activities, which in turn has a negative impact on a firm’s R&D spending (Li et al., 2019), board of directors (Liu et al., 2020), audit risk (Yang et al., 2021), earnings management (Garel et al., 2021), innovation (Pu et al., 2022), and incorporating firm-specific information into stock prices (Zhou and Yao, 2024).

within-portfolio events or characteristics, our measure captures an organization-wide distraction driven by regulatory scrutiny. Such scrutiny involves direct engagement with government agencies, triggers reputational risks, and threatens financial consequences which diverts senior management attention away from routine portfolio monitoring. Furthermore, portfolio-specific measures impact multiple institutions at the same time, whereas regulatory distraction is very specific to a single institution and thus offers exogenous variation.

Second, our study contributes to work on corporate governance and investor monitoring, showing that the quality of shareholder monitoring varies not only with shareholder type or ownership structure, but also with the type of exogenous shocks to the shareholder base. Finally, our findings speak to the ongoing policy debate surrounding the trade-offs in regulatory enforcement. While efforts to monitor financial intermediaries are crucial for promoting market stability, such oversight may inadvertently weaken their capacity to serve as effective monitors of corporate behavior. In this way, regulatory actions intended to strengthen market discipline may come at the cost of diminished corporate governance at the firm level. Acknowledging the negative externalities associated with disciplinary events of institutional investors could help regulators to adjust their procedures during such times.

The remainder of this paper is organized as follows. Section 2 discusses our data, variables, and research design. Our main results are presented in Section 3. Section 4 presents our main evidence on the relation between inattention and the cost of debt as well as the results of cross-sectional heterogeneity tests. Section 4 investigates the performance of firms held by distracted institutions. Section 5 concludes.

2. Data, research design, and descriptive statistics

The data we use to construct the sample for the study come from multiple sources. We get the disciplinary actions against institutional investors from required Form ADV filings on the SEC website. We use historical disciplinary actions to measure institutional distraction. The data on institutional investors' portfolio holdings are from Whale Wisdom. We obtain Merger and Acquisitions from SDC, CEO compensation from Execucomp, dividend events from CRSP, and R&D and capital expenditure, as well as other firm characteristics from Compustat.

2.1. Disciplinary History and Distraction

Registered investment advisors (RIA) with more than \$25 million in assets under management and with 15 or more U.S. clients are required by the SEC to complete Form ADV. Form ADV includes detailed information about RIAs, such as assets under management, governance structure, advisory activities, and advisory affiliates.⁶ Of particular interest is Item 11 of the form, where RIAs are required to disclose any history of past disciplinary events involving the RIA, its advisers, and key personnel within the past 10 years of the filing date.⁷

Investigations conducted by regulatory agencies and potential litigation can take a considerable amount of time, ranging from months to even years. Involvement in an investigation by a regulatory body, such as the SEC, diverts company resources and the executive team's attention for the duration of the ongoing investigations and legal battles. Our running hypothesis is that since attention is a limited resource, an institutional investor's attention to the management of its portfolio and holding firms is compromised during these disciplinary events.

To determine whether an institution is distracted in a quarter, we use the initiation and resolution dates of disciplinary actions reported in Form ADV. We classify an institution as distracted in any quarter during which the initiation or resolution date occurs and any quarter in between. We then define the variable *Distracted* as a dummy equal to one if the institution experienced distraction during the most recent year — that is, in any of the four most recent quarters, including the current quarter. We focus on the four most recent quarters pre-investigation resolution, recognizing that formal investigations by the SEC and other regulatory bodies generally span several months to one or two years. As such, our measure can be considered relatively conservative.

In some cases, the initiation and resolution dates are reported as the same day, typically the day of the press release. While this might imply that a one-day inquiry, the investigative process clearly lasts much longer. These instances usually reflect cases in which regulatory authorities, such as the SEC and FINRA, engage in private negotiations with the company to expedite resolution and minimize the costs associated with prolonged investigative procedures. For example, Oppenheimer & Co. Inc. was fined \$10 million by the SEC and FINRA in 2015 for breaching its fiduciary duty to its clients. In its

⁶ RIAs are required to report any changes to their ADV form within 90 days after the fiscal year end. See Bhandari et al. (2023) for an extended explanation on the ADV Form.

⁷ A disciplinary event is defined as any criminal, regulatory (i.e., federal, state, or foreign), and/or civil judicial action. It refers to instances in which the Securities and Exchange Commission (SEC) or other regulatory agencies, such as the Commodity Futures Trading Commission (CFTC), have found the RIA in violation of rules or regulations, or have imposed a monetary penalty related to investment-related activities.

ADV form, Oppenheimer & Co reported both the initiation and resolution dates as January 27, 2015—the same date the SEC issued its press release.⁸ It is evident that the investigation took place well before the press release date. Such proceedings typically divert attention and resources from company leadership, particularly the executive office, for months up to a year(s) leading up to the resolution of the investigation. Hence, we believe our variable is a conservative yet reasonable proxy for the distraction that institutional investors face preceding the resolution date.

2.2. Institutional investor holdings

All institutional investment managers overseeing portfolios larger than \$100 million are required under Section 13(f) of the Exchange Act of 1934 to file quarterly disclosures with the SEC on Form 13F. These filings must report all holdings exceeding \$10,000 in value and are to be submitted within 45 days of the quarter-end. We collect all institutional investors 13(f) holdings from Whale Wisdom database for the 2001 to 2022 period.

We follow Bonsal et al. (2025) and manually match the RIA's disciplinary information from form ADV with the institutional holdings database using the institution's name, address, and phone number. Specifically, we firm match institution names that appear on Form ADV to institution names on Whale Wisdom. For each matched name, manually check provided address and phone numbers on both data sources and discard any matches with discrepancies in either address or phone numbers. This conservative approach mitigates concerns related to false matches of institutions with similar names, ensuring accurate matching of the institutions between two databases. Around 64 percent of the 13(f) institutional investors in the sample are RIAs that file the required ADV form with the SEC. We measure total institutional ownership in a firm as the ratio of total shares held by institutional investors at the end of the period divided by the firm's total shares outstanding. Similarly, we measure ownership by distracted institutional investors, our main variable of interest, as the sum of shares held by distracted institutions divided by the total number of shares outstanding.

2.3. Cost of Monitoring Variables

We construct a sample of quarterly observations of all firms in the CRSP/Compustat universe with adequate financial information. We exclude firms with insufficient information to calculate needed

⁸ <https://www.sec.gov/newsroom/press-releases/2015-14>

Similar example for Blackrock in our data ordered by SEC to pay \$12 million. Initiation and resolution date is April 20, 2015, same date as the release statement. <https://www.sec.gov/newsroom/press-releases/2015-71>

variables as well as firms in the financial and utilities industries (SIC codes 6000–6999 and 4900–4999). Using CRSP monthly data, we define a dividend cut as the quarter in which a firm announces that it decreases its regular dividend by at least 12.5% while maintaining the same frequency. Similarly, we define a dividend suspension as the quarter in which a firm stops paying a regular cash dividend after paying regular cash dividend for at least two years. Relying on merger and acquisitions from SDC, we identify quarters in which a firm announced an acquisition and makes large, cash, and diversifying acquisitions. Further, we calculate cumulative abnormal returns (CAR) for each announcement and identify bad acquisitions as those with below median CARs. Drawn from Execucomp database, we measure various CEO compensation components including total compensation, salary, bonus, and options granted. Additionally, we measure year-over-year increases for each compensation component. We calculate a set of firm financials from Compustat. Specifically, we measure R&D, capital expenditure, cash holding, book-to-market ratio, leverage, return on assets, and free cash flow. Detailed definitions of all variables are provided in Table A1 of the appendix. Our resulting sample comprises 8,469 individual firms whose stocks are held by 10,852 institutions, over the period 2001–2022. We capture the entire U.S. equity investment universe for institutional investors. Table A2 in the appendix reports descriptive statistics for our main variables and all control variables.⁹ The dummy variable *Distraacted* shows that, on average, 5.4% of institutions in a quarter are under regulatory scrutiny (i.e., distracted). The cross-sectional time-series mean (median) institutional ownership in a firm is 52.5% (57.3), which is similar to other studies.

2.4. Research design

This paper examines the impact of institutional investor distraction due to governance oversight on their monitoring role in corporate governance. To assess the cost of institutional distraction, we examine firm-level outcomes established in prior literature as commonly influenced by institutional monitoring, such as firm performance, dividend policy, CEO compensation, R&D investment, and acquisition activity. Our analysis focuses on periods of exogenous shocks, captured when an institutional investor is under investigation by a regulatory entity, diverting the institution’s attention away from its portfolio.

⁹ Table A1 in the appendix reports all the variable descriptions.

Our empirical approach relies on regressing firm-level outcome variables on the institutional investor distraction measure using linear probability models. Specifically, we estimate the following OLS regression:

$$Y_{i,t} = \beta \times \textit{Distracted}_{i,t} + \Pi \times X_{i,t-1} + \lambda_i + \varepsilon_{i,t} \quad (1)$$

where $Y_{i,t}$ is an outcome variable related to payout policy, acquisitions, executive compensation, investment, and firm performance for firm i at quarter t . $\textit{Distracted}_{i,t}$ is the measure of institutional distraction for firm i in quarter t . $X_{i,t-1}$ is the array of firm characteristics that are used as control variables. Specifically, we control for asset size, market capitalization, ROA, book-to-market ratio, leverage, free cash flows, Tobin's Q , and cash holdings. We also control for total institutional ownership at the firm level. Table A1 of the Appendix provides detailed definition of the variables. Lastly, λ_i is firm fixed effects so that we draw inference from variations in distraction through time from each firm. Our motivation is to rule out the role of any factor varying across firms that may be related to institutional ownership and firm outcomes. In additional robustness tests in the Appendix, we replace the firm fixed effects with Industry fixed effects (and Industry-Quarter fixed effects) and find qualitatively similar results. All independent variables are lagged by a quarter relative to the dependent variable to preclude a look-ahead bias. We use standard errors that are clustered at the firm level.

Equation (1) relates firm outcomes to institutional shareholder distraction during the same quarter allowing us to most directly identify the effect of shareholder distraction on managerial decisions. However, this specification assumes that managers can opportunistically detect and respond to shareholder distraction within a relatively short, three-month window. The assumption of prompt and timely managerial response is reasonable for most of the outcomes we investigate. For instance, management may promptly choose to cut dividends during the same quarter they notice elevated shareholder distraction. Nonetheless, some managerial decisions may require longer deliberations and coordination with other stakeholders. To account for such delayed responses, we estimate an alternative version of Equation (1) in which institutional investor distraction is measured as a three-quarter trailing average, $\textit{Distracted}(t-2, t)$. When examining each firm outcome, we provide evidence using both distraction measures.

When institutional investors are distracted, we should expect not only their monitoring to be impaired but also their trading activities. Hence, to validate that periods of distraction meaningfully

affect institutional investor behavior, we first analyze how institutional portfolio trading activity changes in the quarters they are distracted. We capture this activity using two alternative measures of institutional quarterly churn rate: Yan and Zhang (2009) and Gaspar et. al. (2005). These measures exclude the effects of inflows and outflows from the computations and show how actively the institution is trading in its portfolio, reflecting its portfolio rebalancing and stock picking activities. We regress the churn rates on the institution's distraction indicator, including all control variables (lagged portfolio performance, capital flow, and total assets). We also replicate our results including investor fixed effects, to compare each firm to itself over time, which is particularly important given the exogenous distraction shock we examine affects institutional investors' attention.

Results reported in Table 1, Panel A, show that institutional investor portfolio churn rate declines as institutions' level of distraction increases. This relationship is statistically significant at the ten percent level or better, but statistically insignificant for the GMM churn measure. Following Kempf et al. (2017), we replicate our results using industry fixed-effects (columns three and four) and find that both churn rate measures are negative and statistically significant. These results show that portfolio turnover decreases as the institution becomes more distracted, keeping the industry fixed. The findings in Panel A suggest that institutional investors reduce their trading activity when subject to government disciplinary scrutiny, providing preliminary evidence consistent with a distraction effect. This aligns with Schmidt (2019), who shows that when an institutional investor becomes distracted, measured by the occurrence of an earnings announcement for one of the stocks in its portfolio, it is subsequently less likely to make timely trading decisions for the remainder of its portfolio. In Panel B, we verify our results using the last three-quarter distraction measure and find that the results are statistically significant for both churn metrics (YZ and GMM) with both firm and industry fixed-effects. Although we replicate all our results using both firm and industry fixed effects, for brevity, we only report results with firm-fixed effects in the paper and the industry fixed-effect results in the appendix.

[Insert Table 1 here]

3. Main Results

In this section, we present our main empirical results on whether government scrutiny-induced distraction diminishes an institution's established role as a corporate governance monitor. Our primary focus is on their role in a firm's dividend payout policy, which is more of a routine governance

decision, and acquisitions, a more strategic corporate choice where institutional oversight is particularly important.

3.1. The effect of distraction on dividend payout policy

We begin by investigating the cost of institutional distraction on the firm's dividend payout policy, specifically dividend cuts or omissions. Dividend payouts provide a mechanism to mitigate overinvestment and perks for private consumption by managers (Allen and Michaely, 2003). Companies that distribute their excess cash reduce capital available for managers to invest in low-return projects or to spend on personal benefits. As a result, managers must rely more frequently on external capital markets. This creates an incentive for managers to cut or decrease dividends to avoid exposure to market scrutiny. In addition, dividend levels convey private information about a firm's future prospects to investors (Miller and Modigliani, 1961; Bhattacharya, 1979; Miller and Rock, 1985; John and Williams, 1985). Benartzi et al. (1997) show that dividend cuts announcements generally signal negative expectations for a firm's future cash flow and trigger negative market reactions.

Prior research suggests that firms with higher institutional ownership are less likely to cut dividends, as institutional investors often demand stable and predictable cash flows and may exert pressure on management to maintain dividend payouts. This monitoring role can discipline managers and reduce the likelihood of opportunistic behavior, such as unnecessary dividend reductions or even omissions. In line with this, empirical studies show that institutional investors, as more sophisticated investors, have a positive relationship with a firm's dividend payout policy. Crane et al. (2016) show that higher institutional ownership leads to increased dividend payouts, attributing this relationship to the monitoring role played by institutional investors.

We hypothesize that during periods when institutional investors are distracted, in our particular case due to involvement in investigations or disciplinary actions by regulatory bodies, firms may benefit from muted market reactions and are thus more likely to cut or suspend dividends to preserve cash for future use and reduce external scrutiny. We test this hypothesis by estimating Equation (1), using dividend-related measures as the dependent variables.

Estimation results are reported in Table 2. In Panel A, we use the measure of institutional distraction at quarter t . In column 1, the dependent variable is Dividend Cut, an indicator variable equal to one if the firm announces a decrease in quarterly dividends. We find that firms with more distracted investors are 1.6% more likely to cut their dividends. In column 2, we focus on the extreme instances of changes in dividend policy, specifically where the firm completely suspends its quarterly

dividend stream. Our dependent variable in column 2 is Dividend Omission, which is an indicator variable equal to one when the firm suspends the quarterly dividends. We find that firms with more distracted investors are 1.1% more likely to suspend dividends. Both estimates are positive and statistically significant at 1% level, suggesting that firms are more likely to cut or suspend dividends following a period of distraction by institutional investors. The economic magnitude of this effect is strong. Specifically, a one standard deviation decline in institutional investor attention leads to 16% ($0.016 \times 0.06 / 0.006$) increased *likelihood* of a dividend cut and 22% ($0.011 \times 0.06 / 0.003$) higher likelihood of dividend omission relative to the unconditional sample averages. In column 3, we find similar results when we use the percentage decrease in dividend, Dividend Decrease%, as the dependent variable. Specifically, dividend decreases are larger when institutional investors are distracted.

In Panel B, we use the average institutional distraction between quarters $t-2$ and t . We find similar results in that firms are more likely to decrease dividend amounts or suspend them entirely following periods of elevated institutional investor distraction. The magnitude of the effect is smaller when we allow a lagged response to distraction. Taking column 1, for example, one standard deviation increase in distraction leads to 11% ($0.012 \times 0.055 / 0.006$) higher likelihood of announcing a dividend cut and 9% ($0.005 \times 0.055 / 0.003$) higher likelihood of dividend omission relative to the unconditional average. The smaller effect of distraction in previous quarters on dividend policy is unsurprising, as managerial decisions regarding dividend policy are typically made during the same quarter and do not generally require multiple quarters to implement.

[Insert Table 2 here]

3.2. The effect of distraction on mergers and acquisitions

Mergers and acquisitions are among the largest discretionary investment decisions undertaken by public firms. These investments tend to intensify the inherent conflicts of interest between managers and shareholders in large public corporations (Berle and Means, 1933 and Jensen and Meckling, 1976). While M&A transactions are frequently justified in terms of synergy creation, market expansion, or cost efficiencies, managers may also pursue acquisitions for personal benefits, even when such deals do not create additional value for shareholders. In particular, managers may seek to expand the size and scope of the firm because larger firms often enhance their prestige, power, job security, and compensation (Jensen, 1986). Consistent with the empire-building hypothesis, Lang et al. (1991) show

that firms with high free cash flows are more likely to make value-destroying acquisitions, often reflecting managerial motives related to prestige or personal utility rather than maximizing shareholder wealth considerations. Similarly, Morck et al. (1990) show that some acquisitions, including diversifying ones, can benefit managers at the expense of shareholder value. Furthermore, some acquisitions may provide managers with entry into more glamorous industries, more board seats, or more sprawling operations that enhance their personal status even if they destroy shareholder value. For example, Moeller et al. (2005) find that U.S. public-firm takeovers during the dotcom bubble destroyed aggregate shareholder wealth of \$240 billion. These findings highlight how managerial motives can drive acquisitions that are misaligned with shareholder interests.

If strong shareholder monitoring and governance act as a constraint on managerial discretion, then a reduction in the intensity or effectiveness of such monitoring is expected to increase the likelihood of company decisions that favor managerial self-interest at the expense of shareholder value. Masulis et al. (2007) find that entrenched managers complete worse acquisitions, supporting the hypothesis that managers who face weaker investor discipline are more likely to indulge in empire-building acquisitions that destroy shareholder value. Kempt et. al. (2017) shows that when institutional investors are affected by shocks to the other parts of their portfolios, managers are more likely to complete deals, particularly bad ones.

We hypothesize that managers are more likely to announce acquisition deals when institutional investors are distracted with regulatory investigations and litigation, and thus their monitoring intensity is lower. To test this hypothesis, we estimate Equation (1) where the dependent variable is an indicator variable taking the value of one in quarters when the firm announces an acquisition. Table 3 reports the estimation results. In column 1, we find that firms are more likely to engage in acquisitions when institutions are distracted by ongoing disciplinary actions. A one-standard deviation increase in institutional investor distraction is associated with a 5% ($=0.034 \times 0.06 / 0.038$) higher merger probability, relative to the unconditional average of observing an acquisition.

While some acquisitions are motivated by managers' private benefits, they are often motivated by the creation of value for shareholders. Since shareholder monitoring is concerned with the former, we expect that a decline in monitoring intensity due to disciplinary distraction will mainly affect the acquisitions motivated by managerial self-interest, thereby exacerbating the firm's underlying agency problems. We test this hypothesis by examining subsamples of acquisitions that are more likely to be motivated by managerial self-interest, cash and diversifying acquisitions.

Cash-financed acquisitions have been shown to deliver lower returns at announcement dates (Harford, 1999; Fuller et al, 2002) and weaker post-merger performance (Oler, 2008). These types of acquisitions help acquiring managers to preserve their control and avoid further internal scrutiny. In stock-financed acquisitions, especially those involving relatively large targets, the transaction results in a new, greater shareholder base that has both the capacity and motivation to monitor the acquiring firm's management after the merger. Prior literature suggests that large shareholders actively monitor managers through mechanisms such as voting at shareholder meetings (Agrawal and Mandelker, 1990) and their presence is correlated with better acquisition outcomes (Chen et al, 2007). This implies that managers motivated by personal incentives may prefer to cash-financed acquisition to avoid external monitoring.

Cash deals are also quicker to complete due to their simpler structure. Therefore, if a manager is pursuing an acquisition motivated by self-interest during periods of heightened investor distraction, bidding with cash can be advantageous as it increases the likelihood the transaction will be completed before the temporary distraction dissipates. Based on this reasoning, we predict that the effect of institutional distraction on acquisition activity will be more pronounced for cash-financed deals.

To test this hypothesis, we estimate Equation (1) where the dependent variable is an indicator variable for a cash acquisition. The results are reported in column 2 of Table 4. We find a stronger increase in cash deals when institutional shareholders are distracted. A one-standard deviation increase in institutional investor distraction is associated with a 12% ($=0.043 \times 0.06 / 0.021$) higher merger probability, relative to the unconditional average of observing an acquisition.

We next turn our attention to diversifying acquisitions, which involve a target that is in a different industry than the acquirer. Roll (1986) argues that overconfident managers may overpay for targets due to their belief in their ability to successfully integrate the target and create synergies. Diversifying acquisitions often reflect such hubris at the expense of shareholder value, while increasing managerial private benefits. Specifically, diversifying acquisitions may reduce CEO human capital risk, such as employment risk (Amihud and Lev 1981). They offer managers an opportunity into new lines of business, often fashionable and glamorous ones, to ensure firm survival even when shareholder maximization dictates otherwise (Morck et al., 1990). Furthermore, diversifying acquisitions may provide managers of conglomerates with access to more board appointments, significant prestige and social capital, and political connections.

Using the Fama and French 10 industries, we define diversifying acquisitions as ones where the acquirer and target are from different industries. We estimate Equation (1) using an indicator variable

for whether an acquisition is diversifying as the dependent variable and report our results in column 3 of Table 3. We find an increase in diversifying deals when institutional shareholders are distracted. A one-standard deviation increase in institutional investor distraction is associated with a 6% ($=0.012 \times 0.06 / 0.012$) higher merger probability, relative to the unconditional average of observing an acquisition. These patterns suggest that weakened institutional monitoring, resulting from government oversight, enables managers to pursue acquisitions that primarily serve their own interest rather than creating shareholder value, highlighting a potential unintended consequence of regulating institutional shareholders.

Similar to Section 3.1., our primary measure of institutional investor distraction in Panel A is contemporaneous. Specifically, we relate acquisitions in a given quarter to institutional shareholder distraction in the same quarter, measuring managers' actions in response to temporary distraction in real time. The assumption that managers can act quickly upon observing shareholder distraction in the same quarter is reasonable for some acquisitions, as a typical deal from announcement to completion takes approximately 10 weeks (Fisher, 2017). However, many mergers and acquisitions require longer than one quarter, typically from six to nine months. Therefore, even when a deal is initiated during the high-distraction quarter, several critical steps of the acquisition process may extend to subsequent quarters when the distraction may have been resolved. To account for a slower managerial response, we repeat our analysis with the average of institutional investors' distraction measured between quarters $t-2$ and t . The estimation results, reported in Panel B of Table 4, show a more pronounced effect of periods of distraction on acquisition activity. For the sample of all acquisitions (column 1), we find that, relative to the mean, a one-standard deviation increase in institutional investors' distraction increases the likelihood of an acquisition by 6.5% ($=0.044 \times 0.055 / 0.038$). For the sample of cash acquisitions, a similar increase in distraction leads to 13.6% ($=0.052 \times 0.055 / 0.021$). Lastly, the likelihood of a diversifying acquisition increases by 7.8% ($=0.017 \times 0.055 / 0.012$), relative to the average, following periods of high institutional distraction.

[Insert Table 3 here]

In the previous sections, we have documented that firms are more likely to make an acquisition, especially a diversifying one, if their institutional investor base is distracted due to government scrutiny of their portfolio holdings. In this section, we show that those deals are value destroying.

An advantage of using acquisitions for our empirical question is that their announcements are observable. We use abnormal returns around announcements of deals to evaluate the market's

expectation of value creation. Cumulative abnormal returns (CARs) around the announcement date of a merger are widely used as a market-based measure of the expected value creation (or destruction) of the deal. If the market expects the deal to create value for shareholders, we should observe positive CARs for the acquirer (and target) around the announcement. In contrast, if the deal is expected to destroy value, CARs may be negative or less positive.

Since the source of distraction in our setting is regulatory investigation, disciplinary action, or litigation activity for one (or maybe a few) large shareholders, other shareholders are not distracted and continue to perform their monitoring roles. The implication is that we may observe a short-term stock price reaction to a deal announcement even when institutional shareholder distraction is high. However, lack of attention by a distracted shareholder cannot be costless: other investors would step in to compensate, but the overall level of monitoring is still temporarily reduced. The implication of such weaker managerial oversight is that the announcement CARs may not fully reflect the true value implications of the deal, and thus, this can lead to a post-announcement drift in stock prices. We find evidence supporting both predictions.

To examine the effect of distraction on the value expected to be created or destroyed by an acquisition, we compare the announcement CARs of deals with high levels of investor distraction to that of deals with low levels of distraction. Specifically, we split the sample of all acquisitions into two groups: High-Distraction, those with distraction above the median, and Low-Distraction, those with distraction below the sample median.

In Panel A of Table 4, we compare CARs for all acquisitions and find that acquisitions made by firms highly distracted institutional investors are value-destroying. Specifically, we compute the cumulative abnormal returns (CAR) around three-day and 11-day windows of the acquisition announcement using a four-factor model. We find that acquisitions announced by firms held by highly distracted institutions have 0.77% and 0.84% lower CARs than deals announced by firms held by low distraction institutions around a 3-day and 11-day period, respectively. The economic magnitude of this effect is strong, as the average CAR for a 3-day window is only 1.1%.

Consistent with slower revelation of information in prices due to investor distraction, we find that the abnormal returns during a 30-day window after the deal announcement is 0.44% lower for the group of high-distraction deals. However, this effect is statistically insignificant for the whole sample of deals.

[Insert Table 4 here]

The median acquisition in our sample is only \$56 million, representing a small fraction of the size of the acquiring firms. Thus, the effect of distraction on announcement returns reported in Panel A may be a lower estimate for deals that have non-trivial size relative to the acquiring firm. On one hand, managers are more likely to complete smaller acquisitions during distraction periods, hoping to keep them out of scrutiny. On the other hand, managers only receive significant private benefits only if they complete sufficiently large acquisitions. To understand the effect of distraction on non-trivial deals, we investigate announcement CARs for a subsample of deals that exceed the sample median of \$56 million. We report our results in Panel B. Large deals that are announced by high-distraction firms have 0.49% (0.46%) lower abnormal returns during a 3-day (11-day) window, suggesting that investors expect lower value creation by these acquisitions. However, the difference is smaller than the sample of all acquisitions. This smaller difference is primarily driven by higher CARs for large deals in the high-distraction Portfolio. This is consistent with the fact that smaller transactions are more likely to attract attention and avoid scrutiny during high distraction periods. Moreover, the 30-day post-announcement drift is negative for high distraction deals leading to a 0.91% lower CARs during the period immediately after the deal is announced. This effect is statistically significant, suggesting slower dissemination of information related to the announced transaction when shareholders are distracted.

As discussed earlier, managers are more likely to announce diversifying acquisitions and cash-financed deals during periods of elevated investor distraction. These deals are more likely to be motivated by managers' private interests and thus more likely to destroy shareholder value. We investigate the abnormal returns around the announcement date of these transactions separately. In Panel C, we focus on cash transactions and find similar evidence. Deals announced during periods of high investor distraction have 0.52% (0.7%) lower abnormal returns during a 3-day (11-day) window, suggesting that investors expect lower value creation by these acquisitions. Moreover, the 30-day post-announcement drift is negative for high distraction deals, leading to a 0.61% lower CARs during the period immediately after the deal is announced.

In Panel D, we focus on diversifying transactions and find the strongest evidence. Diversifying acquisitions announced during periods of high investor distraction have 1.02% (1.06%) lower abnormal returns during a 3-day (11-day) window, suggesting that investors expect lower value creation by these acquisitions. The economic magnitude of this effect is very strong, given that the unconditional averages for CARs are 1.1% and 1% for the respective windows. Moreover, the 30-day post-announcement drift is negative and very large at -1.31% for high distraction deals while low-

distraction deals have a modest 0.07% drift. This leads to a 1.38% lower CARs during the 30-day period immediately after the deal is announced because of high distraction.

The findings in Table 5 are consistent with the existing literature that diversifying takeovers and cash acquisitions are generally associated with poorer wealth effects for acquiring firms' shareholders (Harford 1999, Morck et al., (1990), Oler 2008, Fuller et. al. 2002, Harford et. al. 2012). Putting it all together, the evidence suggests that when monitoring is weakened due to institutional investor distraction, not only do firms undertake more deals, but those deals tend to be less value-creating as reflected by lower CARs.

3.3. Institutional trading after dividend cuts and bad acquisitions

When firms make value-reducing decisions, existing research suggests that institutional investors, as sophisticated and informed monitors, respond by “voting with their feet,” that is, reducing or exiting their positions in the firm. Admati and Pfleiderer (2009) show theoretically that large shareholders do not always need to engage in direct monitoring or public activism, as the threat of exiting the firm can discipline managers by reducing agency costs and aligning management interests with those of shareholders. Similarly, Edmans and Manso (2011) show that when multiple smaller blockholders trade based on information, the threat of disciplinary trading is just as effective in inducing higher managerial effort. In a survey of institutional investors, McCahery et al. (2016) report that when direct monitoring fails, institutional shareholders often resort to governance-motivated exit to signal their disapproval with management. Empirical research supports these theoretical predictions. For example, Parrino et al. (2003) and Helwege et. al. (2011) find that institutional ownership and the number of institutional investors decline in the year prior to forced CEO turnover, arguing that institutional investors exit the firm when dissatisfied with management.

Our hypothesis is that, due to their temporary disengagement caused by ongoing disciplinary actions, distracted institutions may respond less effectively, or with delayed response, to such value-reducing events compared to their undistracted counterparts. Dividend cuts or omission announcements as well as value-destroying acquisitions, are negative corporate events to which institutional shareholders may respond by adjusting their portfolio holdings. In contrast, an institutional investor that is temporarily distracted by regulatory investigations or disciplinary actions would be less likely to act following poor outcomes such as a dividend cut or a bad acquisition. This assumption is supported by the evidence in Table 1, which shows that distracted institutional investors

trade less actively. Hence, in this section we examine whether institutional trading behavior around value-diminishing corporate actions is affected during periods of disciplinary distraction.

We start by investigating institutional investors trading activity in the quarter following a firm's dividend cut announcement. Specifically, we test whether distracted investors are less likely to sell their stakes in the firm when the firm announces a dividend cut. First, we define *Distracted* as an indicator taking value of 1 for firms with above-median shareholder distraction during the sample period. Then, we regress institutional trading activity on the dividend cut indicator and its interaction with *Distracted*, at the institutional investor-firm-quarter level. In our regressions, we control for a set of firm-level control variables, including firm's illiquidity, institutional ownership, book-to-market ratio, and market capitalization, as well as, institution-level control variables, including lagged portfolio weight in the firm and lagged portfolio size, flow, and returns. We also include institutional investor fixed effects and quarter fixed effects.

Table 5 reports the results. In column 1, the dependent variable is an indicator variable equal to one if the institution has a large decrease in holdings following the announcement of a dividend cut. Following Parrino et al. (2003), we define a large decrease as a change in holdings within the bottom 20% of the distribution of all holding changes during the quarter. Consistent with the hypothesis that institutional investors vote with their feet following dissatisfaction with managerial actions, we find that the coefficient estimate on dividend cut is positive and significant. Institutional shareholders are 1.4% more likely to liquidate a large portion of their positions in the firm following dividend cuts. More important to our hypothesis, the interaction term is our primary interest, as it captures the effect of distraction on "voting with their feet" as an effective monitoring mechanism for large shareholders. The interaction term enters the equation with a negative and significant coefficient, suggesting that when distracted, investors fail to vote with their feet following a dividend cut. In terms of economic magnitude, distraction fully erodes the threat of exit as a governance mechanism with distracted investors being only 0.1% ($0.014 - 0.013$) likely to sell a large part of their holding in the firm.

In column 2 of Table 5, we use the percent decrease in holdings as the dependent variable to capture the effect on the intensive margin. Following Kemp et al. (2017), we define %Decrease as the percentage change in the fraction of the firm's stock held by an investor if that change is negative, and zero otherwise. We find that institutional investors that are not distracted decrease 2.34% more of their holdings following a dividend cut. In contrast, the average magnitude of the holding decrease for distracted investors is only 0.93% ($2.36 - 1.43$), 61% smaller than other institutional investors. In column 3, we use Exit as an indicator for a full position liquidation as the dependent variable and find

very similar results: institutional investors that are not distracted are more likely to exit the firm after a dividend cut. Whereas distracted institutions do not. Lastly, in Panel B of Table 5 (the first three columns), we estimate the role of distraction on institutional trading activity using the average distraction measure during the prior three quarters. Our results are nearly identical to Panel A indicating that distracted institutional investors are less likely to reduce or liquidate their holdings following a dividend cut, compared to other institutions.

Dividend omissions are a more material change in the firm’s payout policy and thus convey more negative information about the firm. In the last three columns of Table 5, we repeat our analysis for the sample of dividend omissions. As expected, we find similar but stronger patterns. First, investors that not distracted, are even more likely to adjust their holdings and “vote with their feet” following a dividend suspension announcement. This effect is twice as large compared to portfolio changed following dividend cuts. Furthermore, relative to other investors, distracted investors are less likely to adjust their holdings following a dividend omission. However, the effect is smaller compared to distracted investors’ trades following dividend cuts.

[Insert Tables 5 here]

We next turn our attention to institutional shareholders trading activity following bad acquisitions. Goldman et al. (2024) find that institutional shareholders tend to decrease their holdings of acquirers when the deals are value-destroying, arguing that these trades reveal negative information about the firm’s future performance. Conversely, they tend to increase their holdings when the deals are value-creating. Our hypothesis is that following a bad acquisition, institutional investors who are not satisfied with the deal will vote with their feet by decreasing their holdings in the firm. In contrast, investors that are temporarily distracted are less likely to adjust their portfolios due to their limited monitoring capacities during periods of disciplinary distraction.

To investigate how distracted institutions adjust their portfolios following a firm’s announcement of an acquisition, we restrict the sample to quarter-firm observations in which at least one acquisition occurs, allowing us to compare bad acquisitions to good ones. This distinction is important because, unlike dividend cuts, which are unambiguously negative, acquisitions can be either value-enhancing or value-destroying, information that informed institutions would react to. By focusing only on acquisition quarters, we can assess the institutional response to a bad deal relative to a good one.

We define bad deals as acquisitions with a 3-day announcement return below the sample median. Then, we regress changes in institutions portfolio holding on *Bad Deals* and its interaction with

Distracted and report our results in Table 6. In columns 1 – 3, we start with the sample of all acquisitions. Consistent with our hypothesis, we find that while investors that are not distracted decrease their position in the firm following a bad acquisition, distracted investors do not alter their holdings. Taking column 3 for example, non-distracted shareholders are 0.2 percentage points more likely to exit the firm following a bad acquisition, a 5% increase relative to the unconditional average of an exit following an acquisition (unconditional average is 4%). In contrast, the likelihood of an exit by distracted shareholders after a bad acquisition is similar to the likelihood of their exit after a good acquisition, supporting the hypothesis that distraction limits their ability to fully internalize the information and respond accordingly.

Chen et al. (2007) argue that large acquisitions are more likely to be motivated by managerial agency problems. Moreover, because large deals are economically significant, they are more likely to attract the scrutiny of shareholders. Hence, next we repeat our tests focusing on large acquisitions only, defined as acquisitions larger than \$56 million (the sample median acquisition size). In columns 4 – 6, we repeat our analysis for the sample of large transactions and find very similar results, supporting the hypothesis that shareholder distraction limits the monitoring role of voting by trading or exit.

Acquisitions financed with cash are also shown to be less valuable, measured by announcement returns, long-term performance, and synergies (Harford, 1999; Oler, 2008; Fuller et. al., 2002). In columns 7 – 9, we repeat our analysis for the sample of cash deals and find stronger patterns. Taking column 9 for example, non-distracted shareholders are 0.4 percentage point more likely to exit the firm following a bad acquisition, a 10% increase relative to the unconditional average of an exit following an acquisition. In contrast, the likelihood of an exit by distracted shareholders after a bad acquisition is only 0.1 percentage points higher than the likelihood of their exit after a good acquisition, supporting the hypothesis that distraction limits their ability to internalize the information and respond accordingly.

Diversifying acquisitions are more likely to be motivated by managers' private benefits (Morck et al., 1990). In columns 10 – 12, we focus on the sample of diversifying deals and find strong patterns consistent with the mitigating role of distraction on monitoring. Taking column 12 for example, non-distracted shareholders are 0.6 percentage point more likely to exit the firm following a bad acquisition, a 15% increase relative to the unconditional average of an exit following an acquisition. In contrast, the likelihood of an exit by distracted shareholders after a bad acquisition is in fact lower than the likelihood of their exit after a good acquisition.

The results in Table 6 indicate that distracted investors are less responsive to value-destroying acquisition announcements across all types of deals. Overall, the findings in Tables 5, and 6 suggest that distracted institutions do not fully recognize negative corporate events such as dividend cuts/omissions and bad acquisitions, are unable to internalize the negative information, and thus fail to vote with their feet, when they are constrained by ongoing disciplinary actions.

[Insert Table 6 here]

3.4. The effect of distraction on CEO compensation

Although changes in payout policy and acquisitions, due to their infrequent nature, provide a clean setting for identifying the effects of temporary shifts in investor attention on corporate decisions, the investor distraction may have broader implications for firm governance. In particular, the weakened monitoring caused by distracted institutions can also impact CEO compensation, as reduced oversight has the capacity to exacerbate agency problems.

Executive pay is set by the board of directors. This has the potential to worsen the agency problem, as directors may have incentives to favor executives. Typically, the market for corporate control is expected to impose constraints, but these can be loose, thus facilitating large deviations from efficient contracting (Bebchuk et al., 2002). Hartzell and Starks (2003) and Edmans and Holderness (2017) find evidence that institutional investors influence the structure of executive compensation in a firm, highlighting their monitoring role in mitigating the agency conflicts between shareholders and managers. In a survey of directors, Edmans et al. (2023) report that directors believe that shareholders, especially large institutional investors, place constraints on unconventional CEO compensation structures even when higher pay might increase shareholder value. This suggests that directors and institutional investors disagree on the compensation of CEOs.

Building on this literature, we conjecture that temporary shareholder distraction due to disciplinary actions may provide the firm with an opportunity to increase CEO compensation without facing shareholder backlash. We examine multiple aspects of the structure of CEO compensation, including total CEO compensation, Bonuses, and CEO options granted. Moreover, in addition to pay level, we examine increases in CEO compensation. If distraction impairs institutional monitoring effectiveness, then we would expect to find a positive relation between the level of shareholder distraction and CEO compensation and/or increases in CEO compensation.

We test this hypothesis by estimating Equation (1), where the dependent variables are related to CEO compensation. Since compensation values are reported annually, our analysis in this section is based on annual observations and is limited to observations for which compensation values are available in Execucomp. Estimation results are reported in Table 7. Similar to previous results, in Panel A we use the measure of institutional distraction at quarter t . In column 1, the dependent variable is the natural log of total CEO compensation, which includes salary, bonus, equity, options, and deferred compensation. The results show that total CEO compensation is positively related to distracted institutions, but this relation is statistically insignificant. This is not surprising given that most components of executive compensation are determined as part of larger plan well before the year in which shareholders are distracted.

[Insert Table 7 here]

We next examine various components of CEO compensation to shed more light on the effect of distraction. We distinguish between flexible components, which are more likely to respond to shareholder distraction, and pre-determined components, which are less likely to change. The rationale is that institutional engagement in an investigation with a regulatory entity is unlikely to persist indefinitely; thus, the duration of institutional distraction is expected to be temporary. If a firm were to exploit this lapse in monitoring, it would be more effective to do so through flexible compensation components.

Despite the literature's primary focus on executives' stock and option holdings, most CEOs also receive bonuses. While some bonuses are pre-specified, formula-based plans, many firms award discretionary bonuses based on qualitative evaluations of executive performance (Murphy, 1999). CEO salaries, however, are fixed values that are specified at times prior to the distraction period and thus are not expected to be affected by distraction. In column 2, we study CEO bonuses as the dependent variable and find that CEOs receive larger bonuses in periods of investor distraction, consistent with our monitoring hypothesis. The economic magnitude of this effect is strong. Specifically, a one-percent decline in institutional investor attention leads to 4.03% higher bonus. In column 3, we use salaries as the dependent variable and, as expected, find no changes in salaries during periods of distraction. This is important as it shows the evidence related to other components is not simply an artifact of changes in compensation. Rather, it is related to the diminished monitoring role of investors.

Lastly, we focus on stock options granted to CEOs. First, Frydman and Saks (2010) show that option grants are a substantial and important component of executive pay. Second, the valuation of options granted to CEOs is complex and relies on various assumptions, making the values opaque and harder to understand. Third, the literature on CEO compensation has documented various rent-seeking behaviors tied to equity options such as inflating the value of executive option grants through spring loading (Yermack, 1997) and option backdating (Bebchuk et al., 2010). Furthermore, firms actively manipulate the disclosure of information around CEO option awards, delaying the release of good news and accelerating the disclosure of bad news (Aboody and Kasznik, 2000; Chauvin and Shenoy, 2001). Prior research shows that these practices are correlated with weak governance. For example, Bebchuk et al. (2010) show that opportunistic option timing is, among other things, associated with the absence of outside blockholders on the compensation committee. Following this strand of literature, we study options granted to CEOs during distraction periods. Our hypothesis is that a temporary investor distraction due to disciplinary engagements provides the firm an opportunity to maximize CEO compensation by granting options without facing shareholder opposition.

In column 4 of Table 7, we use the number of options granted to the CEO in a given year as the dependent variable and find that CEOs are granted more options during the year institutional investors are distracted. This effect is not only statistically significant at the 1% level but also is economically meaningful. Specifically, a one-percent decline in institutional investor attention leads to 1.22% more options granted to the CEO.

In the specifications of Panel A, our measure of institutional investor distraction is contemporaneous with the quarter in which the CEO compensation announcement is made. Our underlying assumption is that the compensation is determined during the same period. However, it may be that the compensation package is negotiated before the announcement quarter. To account for such timing issue, we repeat our analysis in Panel B with a distraction measure that is the average of three quarters ($t-2, t$). We find similar results to those in Panel A: CEOs are awarded more options and larger bonuses following periods of investor distraction. Moreover, we uncover a significant relation between distraction and total compensation.

Given that our dependent variable in the analysis in Table 7 is the level of compensation, a potential concern arises that firms with more distracted investors may have higher levels of compensation. For example, high-compensation firms may have greater representation of investors that are more likely to get distracted by disciplinary actions, either because such firms align with their investment preferences or because they operate in sectors that are inherently more favorable to them.

Our main specification addresses this problem by the inclusion of firm fixed effects (Table 7) and industry fixed effects (internet appendix). Nonetheless, to further address this concern, we repeat our analysis using the year-over-year increases in CEO pay as the dependent variable. Specifically, we define indicator variables for each compensation component, taking the value of one if the corresponding component increases by at least 20% from the prior year. By examining whether increases in distraction are associated with subsequent increases in CEO pay, we test whether shifts in attention are linked to adjustments in compensation, rather than being merely correlated with the firm's general compensation level.

We report our results in Table 8. In column 1, we define a CEO's total compensation increase as a dummy equal to one if the CEO's total compensation increased by at least 20 percent from the previous year. We find that, although the level of total compensation was not statistically affected by distraction (Table 7), the likelihood of an increase in total compensation is positively affected by distraction. Specifically, a one standard deviation increase in distraction is associated with 1.38% ($0.229 \times 100 \times 0.06$) higher likelihood of an increase of more than 20% in executive compensation. Similarly, find that the CEO's bonus (column 2) and salary (column 3) are more likely to increase by at least 20 percent when shareholder distraction is temporarily elevated. As expected, the effect is more pronounced for bonuses than for salaries. Specifically, a one standard deviation increase in distraction is associated with a 9% ($0.247 \times 100 \times 0.06 / 100 \times 0.161$) increase in the likelihood of a bonus increase but only a 3.5% ($0.095 \times 100 \times 0.06 / 100 \times 0.152$) increase in the likelihood of a salary increase.

[Insert Table 8 here]

3.5. The effect of distraction on investment policy

Lastly, we focus on the impact of the institutional investor distraction on a firm's long-term strategic investment decisions and competitive positioning. Specifically, we examine the firm's investment policy by analyzing two key components: capital expenditure (CapEx) and research and development (R&D) spending. CapEx provides insights into a firm's long-term investments in infrastructure which typically signal confidence in future growth prospects and generate returns in the long term. R&D spending provides perspective on firm's commitment to current and future innovation and technological advancement, which signals the firm's future competitive advantage. Both measures are scaled by total assets.

Under effective institutional monitoring, existing literature suggests that firms are expected to increase both capital expenditures and R&D investments, reflecting a focus on long-term value creation and future growth (Bushee, 1998 and Aghion et al., 2013). Effective institutional monitoring encourages firms to focus on long-term value-creating investments, even if such investments decrease short-term earnings. Conversely, when monitoring weakens, managers may fall prey to short-term pressures by decreasing investments that are costly today but increase firm's short-term returns. Given this framework, we expect that institutional distraction, which temporarily decreases effective monitoring, will be associated with lower capital expenditures and R&D spending in a firm.

Consistent with this hypothesis, the results in Table 9 indicate that firms tend to decrease their capital expenditure and R&D spending when institutional investors are distracted by their disciplinary actions. Both estimates are statistically significant at the 1% level. The results remain the same for the longer-term distraction measure.

[Insert Table 9 here]

4. Performance of firms held by distracted institutional investors

Our empirical results in Section 4 suggest that institutional investors' distraction, while dealing with ongoing disciplinary actions, results in reduced monitoring at their portfolio firms, opening opportunities for value-destroying decisions that are motivated by managerial interests. The portfolio firms are more likely to cut dividends, complete poor acquisitions, increase executive pay, and reduce investments. These value-destroying decisions should lead the firm to lower performance in the long run (Ni et. al., 2020). Hence, this raises the question: Do firms with distracted institutional investors underperform in the long run?

To answer this questions, we estimate Equation (1) where the dependent variable is a long-term performance metric for the firm of up to 12 quarters. The results are reported in Table 13. Panel A reports DGTW-adjusted return and shows that stocks held by distracted institutions underperform in the following quarter and the following year. However, this underperformance disappears when we examine two- and three-year windows following distraction. Using market-adjusted returns in Panel B, calculated as cumulative firm returns minus cumulative S&P 500 returns, we find that firms with distracted institutional investors significantly underperform, and this underperformance persists for up to three years following the event. In terms of economic magnitude, one standard deviation

increase in investor distraction is associated with 1.48% ($0.246 \times 100 \times 0.06$) lower market-adjusted performance in the following three years.

[Insert Table 10 here]

In Panel C, we examine the broader valuation effect of distraction using Tobin's Q and find lower future valuations. Specifically, we find that one standard deviation increase in distraction is associated with 1.69% ($0.283 \times 100 \times 0.06$) lower Tobin's Q three years following the event. The decline in Tobin's Q reinforces the interpretation that institutional shareholder distraction is associated with deterioration in firm value over time, rather than a transitory market reaction. Overall, our results suggest that disciplinary distraction by institutional shareholders may have adverse long-term implications for shareholder value and firm valuation.

5. Conclusions

This paper investigates the consequences of institutional investor distraction on corporate behavior in the firms they hold, specifically when institutions become the focus of government oversight or enforcement actions. Our main findings are that firms held by distracted institutions are more likely to make value-diminishing corporate decisions, suggesting weakened external monitoring. Specifically, CEOs of these firms experience increased bonus compensation. They show capital expenditures and R&D spending decline, pointing to underinvestment in long-term value creation that may have lasting consequences for long-term firm competitiveness. These firms are also more likely to reduce dividend payments or announce dividend omissions, reflecting a shift in shareholder-friendly cash distribution practices. Firms undertake riskier or value-destroying acquisitions, indicating reduced discipline in strategic decision-making. Furthermore, despite these adverse outcomes, distracted institutional investors are less likely to reduce or exit their holdings in poorly performing firms, showing they are slower to react to negative corporate events when distracted.

Collectively, these results paint a consistent picture that institutional investor attention is a critical, finite resource in corporate governance. When attention is diverted, firms exhibit managerial opportunism across multiple dimensions and firm-level decisions reflect reduced oversight and long-term strategic focus. The consistency and depth of these effects underscore the importance of institutional monitoring in constraining managerial behavior. Importantly, the temporary nature of regulatory distractions does not insulate firms from its consequences. Even short lapses in attention can lead to value-destroying decisions with long-term effects in the firm.

This study makes several contributions to the literature. First, we extend research on investor attention and corporate governance by identifying a novel and exogenous source of institutional distraction, regulatory enforcement actions, that constrain institutional monitoring capacity. Second, we contribute to the institutional monitoring literature and provide supporting evidence on the value of day-to-day consistent monitoring and its critical disciplinary role in firm management.

Our findings contribute to ongoing policy debates by highlighting a key trade-off in regulatory design: while oversight of financial intermediaries such as institutional investors is essential for ensuring market integrity and accountability, such regulatory actions may have unintended consequences. Specifically, by diverting institutional attention and resources toward responding to regulatory scrutiny, these efforts can inadvertently weaken their role as effective monitors of corporate behavior. This suggests that, although well-intentioned, regulatory interventions targeting institutional investors may reduce the quality of governance in the firms they hold, precisely when active monitoring is most needed. Hence, policymakers should consider not only whether regulatory actions achieve their objectives, but also their unintended consequences in the diminished governance of portfolio companies. Our results underscore the importance of considering not only the direct objectives of regulations, but also their potential spillover effects on the broader corporate governance ecosystem.

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Table 1: Portfolio Activity & Distraction

	Churn Rate (YZ)	Churn Rate (GMM)	Churn Rate (YZ)	Churn Rate (GMM)
PANEL A: Distracted at t				
Distracted at t	-0.004* (0.088)	-0.026 (0.616)	-0.006** (0.013)	-0.066** (0.032)
Observations	251,683	251,683	251,683	251,683
R2 Adj.	0.452	0.073	0.134	0.017
Control Variables	Yes	Yes	Yes	Yes
Fixed Effects	Investor & Date	Investor & Date	Industry & Date	Industry & Date
PANEL B: Distracted at $(t-2, t)$				
Distracted at $(t-2, t)$	-0.005* (0.075)	-0.034* (0.096)	-0.007*** (0.002)	-0.081** (0.042)
Observations	251,683	251,683	251,683	251,683
R2 Adj.	0.452	0.073	0.134	0.017
Control Variables	Yes	Yes	Yes	Yes
Fixed Effects	Investor & Date	Investor & Date	Industry & Date	Industry & Date

Table 2: Firm dividend payout policy

	Dividend Cut	Dividend Omission	Dividend Decrease %
PANEL A: Concurrent distracted measure			
Distracted at t	0.016*** (0.000)	0.011*** (0.000)	1.299*** (0.000)
Observations	236,460	236,460	236,460
R2 Adj.	0.002	0.002	0.005
Control Variables	Yes	Yes	Yes
Fixed Effects:	Firm	Firm	Firm
PANEL B: Lagged distracted measure			
Distracted at $(t-2, t)$	0.012*** (0.005)	0.005* (0.077)	0.754** (0.021)
Observations	236,460	236,460	236,460
R2 Adj.	0.002	0.002	0.005
Control Variables	Yes	Yes	Yes
Fixed Effects:	Firm	Firm	Firm

Table 3: Mergers and acquisitions

	All M&A	Cash M&A	Diversifying M&A
PANEL A: Concurrent distracted measure			
Distracted at t	0.034*** (0.002)	0.043*** (0.000)	0.012** (0.042)
Observations	236,460	236,460	236,460
R2 Adj.	0.067	0.049	0.038
Control Variables	Yes	Yes	Yes
Fixed Effects:	Firm	Firm	Firm
PANEL B: Lagged distracted measure			
Distracted at $(t-2, t)$	0.044*** (0.001)	0.052*** (0.000)	0.017** (0.000)
Observations	236,460	236,460	236,460
R2 Adj.	0.067	0.049	0.038
Control Variables	Yes	Yes	Yes
Fixed Effects:	Firm	Firm	Firm

Table 4: CARs Around Acquisition Announcements

	High Distraction	Low Distraction	High-Low Distraction
PANEL A: All Acquisitions			
CAR (-1,1)	0.73	1.50	-0.77***
CAR (-5,5)	0.62	1.46	-0.84***
CAR (1,31)	-1.03	-0.58	-0.44
PANEL B: Large Acquisitions			
CAR (-1,1)	0.95	1.44	-0.49**
CAR (-5,5)	0.91	1.37	-0.46*
CAR (1,31)	-0.90	0.01	-0.91**
PANEL C: Cash Acquisitions			
CAR (-1,1)	0.70	1.22	-0.52***
CAR (-5,5)	0.69	1.39	-0.70***
CAR (1,31)	-0.35	0.26	-0.61*
PANEL D: Diversifying Acquisitions			
CAR (-1,1)	0.84	1.86	-1.02***
CAR (-5,5)	0.98	2.04	-1.06***
CAR (1,31)	-1.31	0.07	-1.38***

Table 5: Institutional trading after dividend cuts

	Large Decrease	% Decrease	Exit	Large Decrease	% Decrease	Exit
PANEL A: Concurrent distracted measure						
Distracted at t	-0.002 (0.467)	0.051 (0.866)	-0.002 (0.506)	-0.002 (0.450)	0.042 (0.888)	-0.002 (0.488)
Dividend Cut	0.014*** (0.000)	2.355*** (0.000)	0.014*** (0.000)			
Distracted * Dividend Cut	-0.013*** (0.000)	-1.428*** (0.000)	-0.013*** (0.000)			
Dividend Omission				0.030*** (0.000)	4.091*** (0.000)	0.029*** (0.000)
Distracted * Dividend Omission				-0.011** (0.040)	-0.970 (0.146)	-0.010* (0.058)
Observations	38,870,379	38,870,379	38,870,379	38,870,379	38,870,379	38,870,379
R2 Adj.	0.094	0.104	0.094	0.094	0.104	0.094
Control Variables	Yes	Yes	Yes	Yes	Yes	Yes
Fixed Effects:	Inst. & Qtr	Inst. & Qtr	Inst. & Qtr	Inst. & Qtr	Inst. & Qtr	Inst. & Qtr
PANEL B: Lagged distracted measure						
Distracted at $(t-2, t)$	-0.002 (0.498)	0.156 (0.691)	-0.002 (0.575)	-0.002 (0.482)	0.148 (0.707)	-0.002 (0.558)
Dividend Cut	0.014*** (0.000)	2.361*** (0.000)	0.014*** (0.000)			
Distracted * Dividend Cut	-0.015*** (0.000)	-1.468*** (0.000)	-0.015*** (0.000)			
Dividend Omission				0.030*** (0.000)	4.108*** (0.000)	0.030*** (0.000)
Distracted * Dividend Omission				-0.014** (0.024)	-1.172 (0.122)	-0.013** (0.032)
Observations	38,870,379	38,870,379	38,870,379	38,870,379	38,870,379	38,870,379
R2 Adj.	0.094	0.104	0.094	0.094	0.104	0.094
Control Variables	Yes	Yes	Yes	Yes	Yes	Yes
Fixed Effects:	Inst. & Qtr	Inst. & Qtr	Inst. & Qtr	Inst. & Qtr	Inst. & Qtr	Inst. & Qtr

Table 6: Institutional trading after value-destroying acquisitions

	Large Decrease	% Decrease	Exit	Large Decrease	% Decrease	Exit	Large Decrease	% Decrease	Exit	Large Decrease	% Decrease	Exit
	PANEL A: All Acquisitions			PANEL B: Large acquisitions			PANEL C: Cash acquisitions			PANEL D: Diversifying acquisitions		
Distracted at t	-0.002 (0.518)	0.011 (0.972)	-0.002 (0.540)	-0.002 (0.403)	0.131 (0.692)	-0.002 (0.404)	-0.003 (0.261)	0.071 (0.821)	-0.003 (0.287)	0.001 (0.973)	0.311 (0.454)	0.001 (0.982)
Bad Deal	0.002*** (0.000)	0.272*** (0.000)	0.002*** (0.000)	0.001*** (0.008)	0.206*** (0.000)	0.001*** (0.008)	0.004*** (0.000)	0.501*** (0.000)	0.004*** (0.000)	0.006*** (0.000)	0.800*** (0.000)	0.006*** (0.000)
Distracted at t * Bad Deal	-0.002* (0.075)	-0.046 (0.740)	-0.002* (0.079)	-0.003* (0.083)	-0.188 (0.315)	-0.003* (0.081)	-0.003* (0.095)	-0.261 (0.215)	-0.003* (0.092)	-0.010*** (0.008)	-0.957** (0.018)	-0.010*** (0.008)
Observations	2,798,765	2,798,765	2,798,765	1,793,042	1,793,042	1,793,042	1,760,935	1,760,935	1,760,935	480,404	480,404	480,404
R2 Adj.	0.098	0.11	0.098	0.101	0.114	0.101	0.103	0.116	0.103	0.111	0.12	0.111
Control Var.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Fixed Effects:	Investor + Date	Investor + Date	Investor + Date	Investor + Date	Investor + Date	Investor + Date	Investor + Date	Investor + Date	Investor + Date	Investor + Date	Investor + Date	Investor + Date

Table 7: CEO Compensation

	Total Compensation	Bonus	Salary	Options Granted
PANEL A: Concurrent distracted measure				
Distracted at t	0.120 (0.304)	4.033*** (0.000)	-0.021 (0.813)	1.222*** (0.006)
Observations	19,121	25,023	25,023	24,956
R2 Adj.	0.704	0.399	0.618	0.462
Control Variables	Yes	Yes	Yes	Yes
Fixed Effects:	Firm	Firm	Firm	Firm
PANEL B: Lagged distracted measure				
Distracted at $(t-2, t)$	0.080*** (0.577)	4.998*** (0.000)	-0.130 (0.232)	0.898* (0.091)
Observations	19,121	25,023	25,023	25,956
R2 Adj.	0.704	0.399	0.618	0.461
Control Variables	Yes	Yes	Yes	Yes
Fixed Effects:	Firm	Firm	Firm	Firm

Table 8: Increase in CEO Compensation

	Increase in Total Compensation	Increase in Bonus	Increase in Salary	Increase in Options Granted
PANEL A: Concurrent distracted measure				
Distracted at t	0.229*** (0.009)	0.247*** (0.000)	0.095** (0.018)	0.271*** (0.000)
Observations	15,830	21,808	21,808	21,712
R2 Adj.	-0.001	0.124	0.078	0.079
Control Variables	Yes	Yes	Yes	Yes
Fixed Effects:	Firm	Firm	Firm	Firm
PANEL B: Lagged distracted measure				
Distracted at $(t-2, t)$	0.201** (0.040)	0.327*** (0.000)	0.154*** (0.001)	0.261*** (0.000)
Observations	15,830	21,808	21,808	21,712
R2 Adj.	-0.001	0.124	0.078	0.79
Control Variables	Yes	Yes	Yes	Yes
Fixed Effects:	Firm	Firm	Firm	Firm

Table 9: Firm Capital Expenditure & R&D Investment

	CapEx	R&D
PANEL A: Concurrent distracted measure		
Distracted at t	-0.015*** (0.000)	-0.012*** (0.000)
Observations	236,125	236,125
R2 Adj.	0.555	0.500
Control Variables	Yes	Yes
Fixed Effects:	Firm	Firm
PANEL B: Lagged distracted measure		
Distracted at $(t-2, t)$	-0.004** (0.028)	-0.006*** (0.000)
Observations	236,125	236,125
R2 Adj.	0.555	0.500
Control Variables	Yes	Yes
Fixed Effects:	Firm	Firm

Table 10: Performance of firms with distracted institutions

	$QTR_{(t,t)}$	$QTR_{(t,t+4)}$	$QTR_{(t,t+8)}$	$QTR_{(t,t+12)}$
PANEL A: DGTW Returns				
Distracted	-0.032*** (0.001)	-0.047* (0.094)	-0.018 (0.667)	-0.008 (0.878)
Observations	196890	191535	184548	177092
R2 Adj.	0.037	0.182	0.311	0.407
Control Variables	Yes	Yes	Yes	Yes
Fixed Effects:	Firm	Firm	Firm	Firm
PANEL B: Market-adj. Returns				
Distracted	-0.025** (0.023)	-0.094*** (0.005)	-0.175*** (0.001)	-0.246*** (0.001)
Observations	187629	221537	205003	187629
R2 Adj.	0.063	0.233	0.363	0.445
Control Variables	Yes	Yes	Yes	Yes
Fixed Effects:	Firm	Firm	Firm	Firm
PANEL A: Tobin's Q				
Distracted		-0.038 (0.459)	-0.213*** (0.000)	-0.283*** (0.000)
Observations		236443	236445	236445
R2 Adj.		0.815	0.815	0.825
Control Variables		Yes	Yes	Yes
Fixed Effects:		Firm	Firm	Firm

Note: This table reports stock returns of firms held by distracted institutions. DGTW returns are computed following Daniel et al. (1997). Market-adjusted returns are calculated as cumulative firm returns minus cumulative S&P500 returns for the same period. Tobin's Q is defined as the sum of market capitalization and total debt scaled by total assets. t refers to current quarter.

Appendix: Additional Tables

Table A1: Variable Definitions

Variable Name	Definition	Data Source
Institutional Investor		
Distracted	A dummy equal 1 if the institutional investor is distracted by a disciplinary action in the quarter.	Hand Collected
Distracted (-2,0)	A dummy equal 1 if the institutional investor is distracted by a disciplinary action in at least one of the three latest quarters.	Hand Collected
Institutional Ownership	Total number of shares owned by institutional investors reported by 13F filings, scaled by total number of shares outstanding.	13F/Compustat
Portfolio Churn Rate (YZ)	The lesser of total buy or total sell dollar value scaled by average of assets under management quarters t and t-1.	Yan and Zhang (2009)
Portfolio Churn Rate (GMM)	Absolute value of dollar value of shares traded in a quarter scaled by average of assets in quarters t and t-1, where dollar value of shares traded is defined as price*share in quarter t minus price*share in quarter t-1 minus price change*share in quarter t-1.	Gaspar et al., (2005)
Portfolio Turnover (GMM)	The mean of the last 4 quarters portfolio churn rate, including the current quarter.	Gaspar et al., (2005)
Firm Financials		
Total Assets	Total assets reported by compustat.	Compustat
Market Capitalization	quarter-end close price times number of shares outstanding	Compustat
ROA	Net income divided by total assets.	Compustat
Operating ROA	Income before depreciation and interest divided by total assets	Compustat
CapEx	Capital Expenditure scaled by total assets.	Compustat
Cash	Cash holdings scaled by total assets.	Compustat
Cash Flow	Free Cash Flow (operating income before depreciation minus interest and dividends) scaled by total assets.	Compustat
R&D	R&D expenditure if reported scaled by total assets.	Compustat
Book-to-Market	Book value of common equity divided by market capitalization.	Compustat
Leverage	Long-term debt and short-term liabilities scaled by total assets.	Compustat
Firm Performance		
DGTW (1)	DGTW returns in the quarter t.	
DGTW (1,4)	DGTW cumulative returns for quarters t to t+4.	
DGTW (1,8)	DGTW cumulative returns for quarters t to t+8.	
DGTW (1,12)	DGTW cumulative returns for quarters t to t+12.	
Market-adj. Return (1,4)	Cumulative firm returns minus cumulative S&P500 returns from quarter t to t+4.	CRSP
Market-adj. Return (1,8)	Cumulative firm returns minus cumulative S&P500 returns from quarter t to t+8.	CRSP
Market-adj. Return (1,12)	Cumulative firm returns minus cumulative S&P500 returns from quarter t to t+12.	CRSP
Tobin's Q (1,4)	Average Tobin's Q from quarter t to t+4. Tobin's Q is defined as the sum of market capitalization and total debt scaled by total assets.	Compustat
Tobin's Q (1,8)	Average Tobin's Q from quarter t to t+8. Tobin's Q is defined as the sum of market capitalization and total debt scaled by total assets.	Compustat
Tobin's Q (1,12)	Average Tobin's Q from quarter t to t+12. Tobin's Q is defined as the sum of market capitalization and total debt scaled by total assets.	Compustat

Dividend Policy		
Dividend Cut	A dummy equal to one if the firm announces a decrease in dividends.	CRSP
Dividend Omission	A dummy equal to one if the firm announces a suspension of dividends.	CRSP
Compensation		
Total Compensation	Total Compensation reported in Execucomp for the year (Salary, Bonus, Equity, Options, Deferred).	Execucomp
Bonus	Bonus paid to CEO for the year.	Execucomp
Salary	CEO annual salary.	Execucomp
Salary & Bonus	Sum of salary and bonus for the year.	Execucomp
Options Granted	Black-Scholes estimated value of options granted to CEO during the year.	Execucomp
Lucky Grants	A dummy equal to 1 if at least one tranche of options granted to CEO is granted on a day with the lowest stock price of the month.	Execucomp/ CRSP
Total Compensation Increased	A dummy equal to 1 if CEO's total compensation increased by at least 20% from the previous year.	Execucomp
Bonus Increased	A dummy equal to 1 if CEO's Bonus increased by at least 20% from the previous year.	Execucomp
Salary Increased	A dummy equal to 1 if CEO's Salary increased by at least 20% from the previous year.	Execucomp
Salary & Bonus Increased	A dummy equal to 1 if CEO's sum of bonus and salary increased by at least 20% from the previous year.	Execucomp
Options Granted Increased	A dummy equal to 1 if CEO's BS value of options granted increased by at least 20% from the previous year.	Execucomp
CEO Turnover	A dummy equal to 1 if the CEO is replaced by a new CEO.	Execucomp
Acquisitions		
Acquisition	A dummy equal to 1 if the firm announces an acquisition in the quarter.	SDC
Large Acquisition	A dummy equal to 1 if the firm announces an acquisition larger than \$50 million in the quarter.	SDC
Diversifying Acquisition	A dummy equal to 1 if the firm announces an acquisition in the quarter in which the target is in a different industry according to Fama and French FF10.	SDC
Cash Acquisition	A dummy equal to 1 if the firm announces an acquisition in the quarter paid by cash and not equity.	SDC
Bad Deal	A dummy equal to 1 if the Acquisition announcement CAR is below the median.	SDC/CRSP
CAR (-1,1)	Cumulative Abnormal Return around a 3-day window of the acquisition announcement. Abnormal Returns are measured using a four-factor model.	SDC/CRSP
CAR (-5,5)	Cumulative Abnormal Return around a 11-day window of the acquisition announcement. Abnormal Returns are measured using a four-factor model.	SDC/CRSP
CAR (1,31)	Cumulative Abnormal Return from 1 day after the acquisition announcement to 30 days later. Abnormal Returns are measured using a four-factor model.	SDC/CRSP

Table A2: Summary statistics

Variable	Observations	Average	Median	Std. Dev.
Panel A: Institutional Investors:				
Distracted	249,824	0.054	0.035	0.060
Distracted (-2,0)	249,824	0.054	0.040	0.055
Institutional Ownership	249,824	0.525	0.573	0.310
Panel B: Firm Financials:				
Total Assets	249,824	3,263	323	10,429
Market Capitalization	249,629	3,962	356	12,865
ROA	246,025	-0.024	0.005	0.092
Operating ROA	241,106	0.000	0.022	0.079
CapEx	245,415	0.027	0.014	0.039
Cash	246,398	0.247	0.139	0.265
Cash Flow	237,513	-0.014	0.011	0.079
R&D	249,824	0.020	0.000	0.038
Book-to-Market	246,071	0.546	0.428	0.452
Leverage	246,218	0.515	0.123	1.271
Market-adj. Return (-1)	243,183	0.002	-0.011	0.229
Panel C: Firm Performance:				
DGTW (1)	205,387	-0.010	-0.017	0.192
DGTW (1,4)	199,968	-0.030	-0.060	0.368
DGTW (1,8)	192,870	-0.049	-0.100	0.480
DGTW (1,12)	185,295	-0.060	-0.130	0.551
Market-adj. Return (1,4)	233,458	0.019	-0.037	0.484
Market-adj. Return (1,8)	215,819	0.038	-0.066	0.703
Market-adj. Return (1,12)	197,402	0.048	-0.104	0.898
Tobin's Q (1,4)	249,765	1.787	1.324	1.291
Tobin's Q (1,8)	249,777	1.776	1.333	1.246
Tobin's Q (1,12)	249,784	1.772	1.342	1.220
Panel E: Compensation:				
Total Compensation	26,238	7128	4604	20309
Bonus	26,238	330	0	1268
Salary	26,238	789	738	456
Salary & Bonus	26,238	1119	867	1432
Options Granted	26,159	1550	286	7177
Lucky Grants	19,773	0.080	0.000	0.271
Total Compensation Increased	16,277	0.351	0.000	0.477
Bonus Increased	22,786	0.162	0.000	0.368
Salary Increased	22,786	0.082	0.000	0.275
Salary & Bonus Increased	22,786	0.163	0.000	0.370
Options Granted Increased	22,674	0.218	0.000	0.413
CEO Turnover	104,865	0.014	0.000	0.119

Table A2 (cont.): Summary statistics

Variable	Observations	Average	Median	Std. Dev.
Panel D: Dividend Policy:				
Dividend Cut	249,824	0.006	0.000	0.074
Dividend Suspension	249,824	0.003	0.000	0.053
Panel F: Acquisitions:				
Acquisition	249,824	0.038	0.000	0.191
Diversifying Acquisition	249,824	0.012	0.000	0.108
Cash Acquisition	249,824	0.021	0.000	0.143
CAR (-1,1)	9,500	0.011	0.005	0.067
CAR (-5,5)	9,492	0.010	0.007	0.099
CAR (1,31)	9,500	-0.008	-0.006	0.148