

INCORPORATION CHOICE AND IMPLIED COST OF EQUITY

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[dx.doi.org/10.18374/IJBR-15-3.10](https://doi.org/10.18374/IJBR-15-3.10)

ABSTRACT

Prior studies document a Delaware incorporation effect on firm valuation, generally using Tobin's Q, but the directional effects are mixed and inconclusive. Our study uses implied cost of equity to assess valuation, and we find consistent evidence that firms incorporated outside of their home state, either in Delaware or in other states, have a cost of equity that is 40 to 100 basis points higher than firms incorporated in their home state (depending on the model). Importantly, there is no statistical difference between Delaware incorporation and other non-home states of incorporation, which suggest the more important distinction is home state versus non-home state, rather than a Delaware effect. These findings are robust to controls for risk factors that affect the cost of equity including market beta, market value of equity, book to market ratio, analyst forecast dispersion, long-term growth in earnings, and industry membership. Results are consistent in yearly estimations for the sample period 1990-2006, and robust across the spectrum of firm size, different measures of cost of equity, and to control for endogeneity of the firms' incorporation choice.

Keywords: *Delaware; Incorporation; Corporate law; Cost of equity; Corporate governance; Regulatory competition; Home bias*