Do the Socially Responsible Walk the Talk?

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Comments welcome

Abstract:

Several companies and funds claim to be socially responsible. We confront these high-minded ideals with the data in two settings. In the first setting, we examine the August 2019 declaration by the Business Roundtable (BRT) that a corporation's purpose is to deliver value to all stakeholders, rather than to solely maximize shareholder value. Relative to within-industry peer firms, publicly listed signatories of the BRT statement (i) commit environmental and labor-related compliance violations more often (and pay more in compliance penalties); (ii) have higher market shares; (iii) spend more on lobbying policymakers; (iv) report lower stock returns alphas and worse operating margins. Investors can vote with their feet to enforce managers' statements on corporate purpose. Hence, in the paper's second setting, we study the largest ESG ETF and mutual fund, respectively: the KLD 400 Social ETF and the FTSE4Good US Select index. There is barely any correlation between the initial list of stocks in these funds and additions thereto with "fundamental" ESG data, which we measure using federal environmental and labor-related compliance violations. A key takeaway of our study is that investors ought to be vigilant when assessing claims of stakeholder-oriented practices by firms and ESG funds.

Keywords: social responsibility, ESG, Business Roundtable, environmental and labor laws, ETF, MSCI, KLD, FTSE Russell, Violation Tracker.

JEL classification: M14, G23, G34

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Do the Socially Responsible Walk the Talk?

1. Introduction

The importance of shareholder value maximization has been the subject of much recent debate. In his 2018 annual letter to CEOs, Chairman Larry Fink of BlackRock, the world's largest investment manager with close to $6 trillion under management, warned CEOs that they must both deliver financial performance and contribute to society or risk losing BlackRock's support.[1] Large sections of the asset management industry have followed suit by launching a host of "socially responsible" funds that take into account ESG (environmental, social, governance) issues considered important to the overall sustainability of a business: environmental issues (e.g., carbon efficiency and air/water pollution), social issues (e.g., labor standards and gender diversity), and governance issues (e.g., as executive compensation and board composition). According to the U.S. Forum for Sustainable and Responsible Investing's 2018 *Report on US Sustainable, Responsible, and Impact Investing Trends*, more than $12 trillion of assets under management is explicitly linked to ESG issues.

Perhaps in response to pressure from asset managers, in August 2019, the Business Roundtable (BRT)—a group of CEOs who lead many of the largest and most influential U.S. companies—released a statement on "the purpose of a corporation" which explicitly states that a corporation's sole purpose is to not to merely maximize profits in a quest for greater shareholder value. Prior to this, the BRT had explicitly endorsed (since 1997) a model of shareholder primacy, i.e., that "corporations exist principally to serve shareholders."[2] In contrast, the new BRT statement asserts, "we share a fundamental commitment to all of our stakeholders…each of our stakeholders is essential…we commit to deliver value to all of

[1] This letter is available at https://www.blackrock.com/corporate/investor-relations/2018-larry-fink-ceo-letter.

[2] This phrasing is quoted directly from the BRT's press release announcing the updated 2019 *Statement on the Purpose of a Corporation*. This press release is available at https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans

them, for the future success of our companies, our communities, and our country."

In this paper, we attempt to verify whether these high-minded ideals, espoused by both companies and the asset management industry, are borne out by the evidence. In particular, we report the results of two empirical tests: (i) we identify the publicly listed firms that signed the BRT statement and cross-verify their track record with stakeholders other than shareholders; and (ii) we identify mutual funds that claim to be ESG friendly and track the stakeholder orientation of stocks included in and added to these funds.

Our findings are sobering. Relative to within-industry peer firms, signatories of the BRT statement have higher rates of environmental and labor-related compliance violations (and pay more in compliance penalties as a result), despite the BRT statement's specific reference to employees and the environment. These compliance violations do not just reflect trivial matters; BRT signatories are also more likely to have paid a settlement in lawsuits alleging workplace discrimination or wage theft. Signatory firms have higher market shares, suggesting that they may be more likely to face scrutiny in future mergers and acquisitions (M&A) transactions. Consistent with the idea that BRT signatories attempt to head off potential regulatory scrutiny, they spend more on lobbying policymakers than their non-signatory counterparts. Moreover, our findings on market shares and lobbying are unlikely to reflect superior business performance because signatory firms report lower stock returns alphas and worse operating margins. Despite this underperformance, we find that BRT signatories' CEOs are paid more relative to peer firms; this may be associated with the finding that BRT signatories' boards contain a lower percentage of independent directors, relative to non-signatory firms.[3] An event study around the announcement of the BRT pledge

[3] Relatedly, BRT signatories have recently also supported proposals to make it more difficult to file shareholder resolutions and to resubmit proposals that previously did not pass. A comment letter to the SEC by the BRT indicating this stance is available at https://corpgov.law.harvard.edu/2020/02/28/business-roundtable-comment-letter-to-sec-on-proposed-proxy-rules-for-proxy-voting-advice/

does not appear to affect the stock prices of the BRT signatories, suggesting that the market viewed the BRT *Statement* as cheap talk rather than a commitment to change. Overall, our results suggest that signatory firms have not historically "walked the talk" with respect to stakeholder orientation.

Asset managers can enforce managers' potential statements about corporate purpose through their choice of investment vehicles. Morningstar documents a nearly 50% increase from 2017 to 2018 alone in the number ESG funds available in the US market. Hence, we focus on whether stocks added by the largest ESG ETF and mutual fund, respectively (BlackRock's iShares MSCI KLD 400 Social ETF, which tracks MSCI's KLD 400 social index, and Vanguard's FTSE Russell FTSE4Good US Select index) walk the talk while choosing socially responsible firms in their portfolios. We find that stocks are less likely to be added by socially responsible mutual funds when there is more negative media coverage of the firm. However, while we find some cross-sectional evidence of a link between index membership and firms' "fundamental" ESG records, which we measure as the underlying firms' federal enforcement records related to environmental and labor laws, there is hardly any correlation between index additions or deletions and "fundamental" ESG data. We also do not find evidence to suggest that these indices account for governance-related best practices; index inclusion is not inhibited by excess compensation or managerial entrenchment, and firms are more likely to be added to both indices, ceteris paribus, when they have a *lower* percentage of independent directors.

A potential explanation for our results is that addition to ESG indices predicts future improvements in corporate conduct. However, this explanation is not borne out by the data as firms' compliance records do not improve subsequent to inclusion in an index. Moreover, for both the KLD400 and FTSE4Good US Select indices, index inclusion does not appear to be associated with subsequent levels of CEO compensation or entrenchment, and firms appear to

decrease the percentage of independent directors subsequent to index inclusion. These results suggest that index inclusion is associated with minimal, if any, improvements in corporate governance. Relatedly, our paper raises questions on whether the ESG scores marketed by intermediaries capture anything more than negative media mentions. A key takeaway of our study is that investors ought to be vigilant when assessing claims of stakeholder-oriented practices.

Our work contributes to emerging literature on how corporate purpose and concern for stakeholders is actually operationalized by firms and the asset management industry. First, although the financial press and academic literature have discussed corporate purpose, few attempts have been made to verify whether concern for employees, environment and governance is actually consistent with the track record of firms claiming to adopt purpose as the key tenet to manage their companies. Our work complements Guiso, Sapienza, and Zingales (2015) who find no association between the values advertised in firms' mission statements on their corporate websites and firm value. Unlike Guiso et al. (2015), we benchmark firms' advertised concerns for stakeholders against their publicly verifiable track record with such stakeholders. Gartenberg, Prat and Serafeim (2019) and Gartenberg and Serafeim (2019) draw their data from the Great Places to Work Institute and effectively assume that firms whose employees feel good about working for their employers have fulfilled their corporate purpose. However, we verify whether firms' proclamation of purpose is borne out by the data, as opposed to the other way around. In light of the recent explosion of both voluntary and mandatory corporate social responsibility disclosures highlighted by Christensen, Hail, and Leuz (2019), our findings suggest that such disclosures ought to contain verifiable, cross-sectionally comparable "hard" information on stakeholder treatment.

Second, empirical research that examines whether ESG funds actually deliver on their promise to focus on ESG friendly stocks is sparse. Our evidence questions whether the

stocks added and deleted by socially responsible mutual funds (hereafter ESG funds) actually reflect the social values they espouse to target. Finally, consistent with early work by Chatterjee et al. (2009) and contemporaneous work by Yang (2019), our paper asks whether commercial vendors' ESG scores really capture firms' ESG behavior. Many published academic studies rely on these commercial ratings to measure firms' ESG behavior. We caution that greater restraint may be warranted while interpreting findings that rely on ESG ratings of commercial vendors.

The remainder of the paper is organized as follows. In Section 2, we provide further background regarding our settings as well as an overview of related literature. Section 3 outlines our data. Section 4 describes our research designs concerning both the BRT and the ESG indices. Section 5 discusses our results. Finally, Section 6 concludes.

2. Background

Our work is related to three strands of the academic literature: on (i) corporate purpose; (ii) socially responsible mutual funds; and (iii) ESG ratings.

2.1 Prior work on corporate purpose

Although popular and scholarly discourse about corporate purpose has surged in recent times (e.g., Strine 2019, Yosifon 2013, Kaplan and Henderson 2005, Blader et al. 2015, Thakor and Quinn 2013, Henderson and Van Steen 2015), very few empirical studies have investigated associations between corporate purpose and firm behavior. This is because corporate purpose is hard to define and even harder to measure. Thakor and Quinn (2013) define purpose as "something that is perceived as producing a social benefit over and above the tangible pecuniary payoff that is shared by the principal and the agent." Henderson and Van den Steen (2015) state that purpose is "a concrete goal or objective for the firm that reaches beyond profit maximization."

The empirical evidence linking purpose and performance is scant and mixed. Guiso, Sapienza, and Zingales (2015) find no association between the values advertised in the firm's mission statements on their corporate websites and firm value. Relying on a large survey of corporate executives, Graham, Grennan, Harvey and Rajgopal (2019) report that convergence between these stated aspirational values of a firm and the actual day-to-day social norms reflecting these values is associated with positive corporate outcomes such as greater productivity, innovation and ethical behavior.

Gartenberg, Prat and Serafeim (2019) draw their data from the Great Places to Work Institute and empirically measure purpose as the strength of their responses to four survey questions related to the meaning and impact of work on employees lives ("My work has special meaning: this is 'not just a job," "When I look at what we accomplish, I feel a sense of pride;" "I feel good about the ways we contribute to the community," and "I'm proud to tell others I work here"). They find a significant positive association between the employees' strength of feelings about working for their company and future operating and stock return performance. In a follow up paper, Gartenberg and Serafeim (2019) find that the strength of employee beliefs about their firm is lower in public companies.

Because our objective is partly to confront the BRT signatories and ESG funds with their advertised missions, we sidestep the controversy surrounding how to define and measure purpose. Instead, we simply investigate whether BRT signatories' concern for all stakeholders is corroborated by their enforcement records with various federal agencies that represent some of these stakeholders. Given the BRT statement's specific reference to environmental concerns and employees' welfare, we focus on compliance violations assessed by the federal agencies most relevant to these topics. The three agencies that comprise the bulk of our environmental and labor violation data are (i) the Environmental Protection Agency (EPA), for which violations capture a firm's (lack of) commitment to the

environment; (ii) the Occupational Safety and Health Administration (OSHA), for which violations capture a firm's (lack of) commitment to providing employees with a safe workplace; (iii) the Wage & Hour Division (WHD), for which violations capture a firm's (lack of) commitment to paying workers fairly, and in accordance with all applicable laws.

Similarly, when we study ESG-oriented funds, we consider the compliance violations detailed above. Most ESG funds claim to select firms based on (among other criteria) their environmental practices or employees' satisfaction. Employees who are underpaid or in unsafe workplaces are likely to exhibit lower levels of satisfaction. Hence, if ESG funds truly screened for firms with superior performance related to the environment and employee satisfaction, we should observe superior compliance records along these dimensions for portfolio firms relative to non-portfolio firms. In addition, to address the balance of power between managers and shareholders (the "G" in ESG), we consider several issues related to governance and entrenchment. If ESG funds actively identified firms based on their governance, then we should find higher levels of corporate governance in portfolio firms relative to similar non-portfolio firms.

2.2 Prior work on socially responsible mutual funds

Empirical work on socially responsible mutual funds in the academic literature is sparse. As documented later in section 5, we show that the federal enforcement records of stocks do not explain or predict stocks added or deleted by ESG funds. Ramchander et al. (2012) document that announcements of additions (deletions) to the Domini Social 400 (DS400) index, a prominent stock market social responsibility benchmark, are associated with positive (negative) stock prices of such firms.[4]

Whether socially responsible funds earn abnormal returns is unclear. Sauer (1997) and Statman (2000) find no significant difference between the performance of the Domini

[4] The DS400 became the KLD400 when MSCI bought KLD in 2010.

Social Index (a Socially Responsible Index or screened version of the conventional S&P 500) and the S&P 500. Statman (2006) reaches the same conclusion when the sample is extended to four popular SRI indices (Domini Social Index, Calvert's Social Index, Citizen's Index and Dow Jones Sustainability US Index) and a longer time period. We document that the additions and deletions of stocks to socially responsible mutual funds do not even appear to stand out on the dimensions of social responsibility that we examine.

2.3 Prior work on ESG ratings

Tens, if not hundreds, of published academic articles in management, finance and accounting have relied on ESG ratings provided by commercial vendors such as KLD (now MSCI) and Asset 4. Most of these papers implicitly assume that these ESG ratings supplied by commercial vendors actually measure the environmental, social and governance of a firm. Not as much energy has been devoted to validating these ratings. We show that MSCI's KLD ratings and the screening technique followed by FTSE Russell, which forms the foundation for stock picks by our ESG funds, behave as though they add stocks that have received positive media mentions. However, federal enforcement records pertaining to environmental and labor-related issues, which we view as fundamental data relevant to stakeholders, neither explains nor predicts MSCI upgrades and downgrades.

3. Data

3.1 Business Roundtable

The Business Roundtable publicly lists on its website the 183 signatories to the *Statement on the Purpose of a Corporation*.[5] We download this signatory list and hand-match the set of companies to Compustat and CRSP. In doing so, as shown in panel A of

[5] See https://opportunity.businessroundtable.org/wp-content/uploads/2019/09/BRT-Statement-on-the-Purpose-of-a-Corporation-with-Signatures-1.pdf. The list was first published on August 19, 2019 with 181 signatories and subsequently updated on September 6, 2019 with two new signatories (McKinsey & Co. and Grant Thornton LLP) for a total of 183.

Table 1, we are able to identify 157 American publicly traded signatories of the Business Roundtable purpose statement. Of the remaining 26 companies, 25 are private; the remaining firm, Turner Construction Company, is a subsidiary of a German public firm. We require firms to have available data in Compustat and CRSP for the five most recent fiscal years (2014-2018) in order to assess signatory firms' corporate conduct over a sufficient time period prior to signing the *Statement*. Imposing this restriction reduces our sample to 118 publicly traded Business Roundtable signatories.

3.2 ESG Indices

The largest ESG indices tracked by mutual funds and ETFs are published by MSCI Inc. and FTSE Russell. While MSCI and FTSE Russell publish both U.S. and global ESG indices, as our focus is on U.S. firms we define our ESG index membership variables to reflect membership in either MSCI's or FTSE Russell's most popular US indices. These are the MSCI KLD 400 Social Index (hereafter KLD 400) and FTSE4Good US Select Index (hereafter FTSE4Good), respectively. We are able to obtain month-end holdings for each of these two indices from CRSP. We outline in more detail how MSCI and FTSE Russell construct these indices below. As of this writing, the FTSE4Good index has approximately $13.8 billion in tracked assets under management, while the KLD 400 has approximately $1.9 billion in assets under management.

Although the KLD 400 based fund has a smaller asset base, we study that index because (i) the KLD 400 based fund is the largest ESG ETF (though the assets under management for ESG ETFs tends to be smaller than assets under management (AUM) for ESG mutual funds); and (ii) the KLD 400 based fund is the most prominent ESG fund that explicitly tracks well-known CSR scores and prior academic work has focused extensively on this index (when it was the Domini Social (or "DS") 400).

3.2.1 KLD 400 Index

MSCI's KLD 400 index contains 400 stocks at a time and is similar to the S&P 500 in its use of a one-in-one-out membership strategy: a firm added to the KLD 400 replaces another firm that is concurrently removed from the KLD 400. The index updates occur four times a year: in February, May, August, and November. Update announcements (with a list of additions and deletions) are provided in the middle of these months, and the composition of the underlying indices changes on the first trading day of the next month (March, June, September, and December). These dates represent a useful econometric feature as they do not coincide with the vast majority of firms' quarter-end or quarterly earnings announcement dates. Trading activity around index inclusion dates is therefore unlikely to reflect a response to new information about firm fundamentals.

MSCI uses a multifaceted approach to determining index membership. Firms in certain industries (such as alcohol, tobacco, gambling, and firearms) are excluded from the index for ethical reasons. In other industries, whether a firm is included in the index depends jointly on its size as well as on proprietary ratings of firms' environmental, social, and governance (ESG) computed by MSCI (formerly the Kinder, Lydenburg, and Domini – or KLD – ratings). The majority of firms in the KLD 400 index are large, publicly traded firms. For example, 58% of KLD 400 firm-years in our sample are also in the S&P 500 index. The inclusion of large firms in the KLD 400 is not purely a function of those firms' ESG practices. More specifically, large firms are added to the KLD 400 as long as they are not in an excluded industry and meet a minimum ESG rating, and are subsequently value-weighted. MSCI begins by identifying all such large firms; if there are fewer than 400 such firms in a given year, then the remaining constituents in the index are small-cap firms chosen purely based on ESG rating. The cumulative weight assigned to such small-cap firms is typically less than 10% of the total value-weighted index. For further details on the construction of the

KLD 400, we refer the reader to the *MSCI KLD 400 Social Index Methodology* factsheet.[6] Finally, in addition to index membership, we obtain MSCI's corporate social responsibility (CSR) ratings directly. These ratings are commonly used in other studies of corporate social responsibility.

3.2.2 FTSE4Good Index

The FTSE4Good US Select index is tracked by Vanguard's FTSE Social Index Fund – which was, until recently, the largest ESG-focused mutual fund available to retail investors. Unlike the KLD 400, the FTSE4Good US Select index does not enforce an explicit cap on the number of firms in the index at any one time. The FTSE4Good US Select index is obtained primarily using exclusionary criteria. More specifically, any firm in the FTSE USA All-World Index (roughly the largest 600 American firms by market capitalization) that does not fall into a set of blacklisted industries (e.g., alcohol or gambling), and that meets a set of relatively weak activity-based criteria (e.g., no "significant controversies" regarding human rights violations) is included in the FTSE4Good US Select index. There is no explicit cap on the number of firms included in the FTSE4Good US Select index, and the number of firms included in the index varies over time. In our sample, we observe between 344 and 402 firms in the index in any given year.

3.3 Compliance violations

To test whether Business Roundtable signatories have historically had, and whether ESG index membership indicates, better corporate conduct we incorporate data on compliance violations with respect to federal laws. We obtain this data from the Violation Tracker database, compiled by the non-profit organization Good Jobs First. Violation Tracker provides comprehensive coverage of violations of federal laws written by over 50 US federal

[6] This factsheet is available at https://www.msci.com/eqb/methodology/meth_docs/MSCI_KLD_400_Social_Index_Methodology_May2018.pdf

agencies; we provide a full list of types of violations in Appendix A. The most common type of violation observed in Violation Tracker pertains to workplace safety, in the form of Occupational Safety & Health Administration (OSHA) violations. Other common types of violations pertain to labor (for example, underpayment of workers or taking illegal actions to dissuade unionization), the environment, and product safety. These violations occur across a broad cross-section of industries. We measure compliance violations in three ways. First, we consider compliance violations irrespective of the penalizing agency. Second, because of the Business Roundtable *Statement's* explicit references to the welfare of employees and the environment, we separately measure compliance violations pertaining to labor and the environment, based on the focus of the federal agency issuing the violation.

Following Li and Raghunandan (2020), we classify agencies as labor-related, environment-related, or neither. More specifically, we classify the following nine agencies as regulating labor issues: the Employee Benefits Security Administration (EBSA), Equal Employment Opportunity Commission (EEOC), Federal Motor Carrier Safety Administration (FMCSA), Federal Railroad Administration (FRA), Department of Health & Human Services Office of Inspector General (HHSOIG), Mine Safety & Health Administration (MSHA), National Labor Relations Board (NLRB), Occupational Safety and Health Administration (OSHA), and Department of Labor Wage & Hour Division (WHD). We classify as regulating environmental issues the Bureau of Safety and Environmental Enforcement (BSEE); Department of Energy (DOE); Environmental Protection Agency (EPA); Federal Energy Regulatory Commission (FERC); Fish and Wildlife Service (FWS); National Oceanic and Atmospheric Administration (NOAA); Nuclear Regulatory Commission (NRC); Office of Natural Resources Revenue (ONRR); Pipeline and Hazardous Materials Safety Administration (PHMSA); and US Department of Agriculture (USDA). The majority of

labor-related violations are issued by OSHA and WHD; the majority of environmental violations are issued by the EPA.

Because of constraints codified into federal law, the fines assessed for these violations are typically quite small relative to violation severity and, for the firms that we study, immaterial compared to earnings or sales. For example, the median penalty for noncompliance with workplace safety regulations assessed by OSHA is less than $10,000. The NLRB is prohibited by law from assessing punitive damages in addition to any back pay or lost wages a company may owe.

We view this feature as an econometrically beneficial aspect of the compliance data. More specifically, one concern with ESG indices is that the underlying index inclusion methodology is primarily focused on financial performance, in which case labelling such indices as "ESG"-focused amounts to window-dressing. If ESG indices indeed account for compliance violations in index addition decisions, we would expect such additions to reflect a purer focus on underlying ESG practices, rather than on financial considerations because the penalties are almost never financially material for the large firms that comprise our sample.[7]

3.4 Control variables

For our Business Roundtable *Statement* and ESG index-related tests, we construct control variables that are financial or news-related in nature because (i) negative ESG news is easier to observe than the true underlying ESG record of firm; and (ii) we suspect that ESG index membership decisions reflect such news regardless of whether such news reflects the true ESG record of the firm. We outline these variables and their sources below.

[7] Regulatory constraints (e.g., fine structures codified into law) prevent fines from increasing at the same rate as the economic impact of the violations they are assessed for. For example, the National Labor Relations Board (NLRB) is not allowed by law to assess any punitive damages; it can only collect back pay and lost wages. Similarly, OSHA and the WHD have rigid fine schedules that do not often change. For instance, OSHA's fine schedule has changed twice in the last 30 years (once in 1990 and then in 2015, as per the Wall Street Journal https://www.wsj.com/articles/osha-fines-to-rise-for-first-time-since-1990-1446603819). As an illustration of our point, note that OSHA cannot charge more for a violation if it results in a worker's death, relative to a similar violation that does not result in fatalities. While a few agencies, like the DOJ, have a lot of flexibility with respect to the size of the penalty, such observations constitute a small percentage of our sample.

3.4.1 RepRisk

We obtain data on news coverage of our sample firms from RepRisk. RepRisk is a data provider that specializes in ESG risk-related research. One of its key databases compiles a comprehensive list of negative ESG-related news articles for covered firms and classifies various attributes of these articles. RepRisk's focus on negative news means that we cannot assess the impact of positive coverage on ESG index addition or deletion decisions. For each article, RepRisk identifies the main topic (labor, environment, human rights, or corruption) as well as a measure of "severity" (low, medium, or high) and "reach" (again low, medium, or high). Severity reflects the underlying news itself, while reach reflects the influence of the news source. Hence, reach and severity are not perfectly correlated. We retain articles with medium or high severity as well as medium or high reach and construct indicator variables based on topic and either reach or severity. RepRisk began its coverage in 2007 and, as of this writing, RepRisk's data coverage period runs through 2017. We are not able to perfectly map individual articles analyzed in RepRisk with specific violations. However, firms with serious violations (measured by penalty amount) are more likely to be covered in RepRisk in a given year.

3.4.2 Financial data

Because our primary tests use financially-motivated dependent variables, we select several key financial indicators as control variables. We select these variables based on prior literature. These variables include firm size (measured both using total assets and market value), market to book ratio, returns, return volatility, sales growth, and leverage. We obtain this data from Compustat and CRSP. Our results are not particularly sensitive to the choice of control variables; in untabulated alternative specifications we omit certain variables and/or use alternative measures of the constructs above (for example, the number of employees to measure size). Doing so does not change our inferences.

4.0 Business Roundtable Signatories

We outline below how we construct tests of our first setting related to the Business Roundtable.

4.1 Research design

Our main goal in studying the Business Roundtable's *Statement* is to assess whether signatories tend to "practice what they preach," relative to non-signatory firms. To this end, it is important to find an appropriate control group, because signatory firms are not randomly drawn from the set of all publicly traded firms. Signatory firms are among the largest in their respective industries, with more than half being members of the S&P 500. We therefore employ propensity score matching to identify appropriate non-signatory control firms for the Business Roundtable, using a nearest-neighbor approach based on propensity scores generated from a logit model and matching based on firm fundamentals (market value, market to book ratio, change in ROA, sales growth, leverage, returns and return volatility) within industry and year. We match, with replacement, based on 2018 characteristics to align our treatment (signatory) firms with their control firms based on a time as close as possible to the signing of the *Statement*; we then apply these matches to other sample years to ensure constant treatment-control matches throughout the sample period. Hence, as shown in panel A of Table 1, our final sample consists of 118 Business Roundtable signatories and 81 distinct control firms, spanning 1,180 weighted firm-years from 2014 to 2018. Using our matched sample, we assess whether Business Roundtable signatories have historically outperformed peer firms with respect to non-financial ESG performance. We conduct tests of the following form:

$$BEHAVIOR_{it} = \beta_0 + \beta_1 SIGNATORY_{\ i} + \beta_2 Controls + Industry_i + \eta_t + \varepsilon_{it} \quad (1)$$

where $BEHAVIOR_{it}$ represents measures of firm conduct and $SIGNATORY_i$ is an indicator that equals 1 for Business Roundtable signatory firms. In Equation (1), we estimate a probit model when $BEHAVIOR_{it}$ is binary and a linear model when $BEHAVIOR_{it}$ is continuous. We employ industry fixed effects because $SIGNATORY_i$ is a cross-sectional characteristic. Hence, we cannot use a firm fixed-effects design. We also include year fixed effects.[8]

Our primary measure of $BEHAVIOR_{it}$ is constructed based on violations of federal law using *Violation Tracker*. More specifically, the Business Roundtable's *Statement* suggests a need to improve the treatment of non-shareholder stakeholders in a firm. If signatory firms are, in fact, leaders in this regard, we should observe fewer – and/or less severe – violations reflective of harm done toward their customers and employees relative to non-signatory firms. That is, we would expect a negative value of β_1. By turn, we focus (i) on all violations, (ii) on only labor-related violations, and (iii) on only environmental violations. We consider items (ii) and (iii) because of the BRT *Statement'*s explicit mention of the need to do right by employees and the environment. Because the *Statement* also alludes to doing right by customers, we collect data on customer satisfaction from the American Consumer Satisfaction Index (ACSI). However, there is minimal overlap between the set of firms covered by the ACSI and the signatories of the BRT. Hence, we are unable to feasibly test whether BRT signatories exhibit better customer satisfaction relative to their peers.

Another view of the Business Roundtable *Statement'*s signatories is that these firms are not outperformers with respect to corporate conduct. Instead, signatory firms potentially seek to preserve rents in the face of increasing political and popular backlash against large, powerful corporations. Our second goal in comparing Business Roundtable signatories to

[8] In an alternative specification, in lieu of industry fixed effects we include fixed effects for each signatory-treatment matched pair in our sample. Our inferences are unchanged. We prefer to tabulate the specification given in Equation (1) above because the inclusion of matched pair fixed effects leads to a smaller sample size for violation-related tests because of the perfect separation problem (i.e., matched pairs in which both firms never have a violation or always have a violation will drop out of the estimation)

their peers, therefore, is to test whether Business Roundtable signatories are associated with rent-seeking behavior. To do so, we consider proxies for financial performance and potential external scrutiny to construct alternative measures for $BEHAVIOR_{it}$. We focus on abnormal compensation, market share, and stock price performance.

Abnormal CEO compensation reflects potentially poor corporate governance and rent extraction. To measure abnormal compensation, we follow Larcker, Ormazabal, and Taylor (2011) and compute median CEO compensation within size quintiles (based on market value) within Fama-French 12 industry. Abnormal CEO compensation is then measured as actual CEO compensation minus the industry-size quintile median level of compensation. We obtain compensation data from Execucomp, using TDC1 (which relies on company assessed fair values of stock and options on the grant date). After doing so, we re-estimate equation (1) with log abnormal CEO compensation as $BEHAVIOR_{it}$.

Our next test of whether signatory firms enjoy higher market shares relative to their peers, is driven by the fact that dominant players are often subject to higher levels of scrutiny. A dominant firm may therefore seek to curry favor with regulators – directly or indirectly – in order to pre-empt scrutiny, especially if the firm may subsequently seek to engage in mergers or acquisitions. While we do not take the position that being a dominant player in an industry is a bad development for firms or their investors, our goal is to test whether heightened scrutiny leads to firms taking actions to signal virtue. We also conduct a similar test using operating margins (measured as the ratio of EBIT to sales) as the dependent variable. While margins may not directly attract regulatory scrutiny, signatory firms with lower-than-expected operating margins may invite scrutiny from investors, especially activists. Finally, we consider Fama-French alphas as a measure of firm performance in order to test whether signatory firms systematically outperform their peers (which could help explain differences in market share).

4.2 Descriptive statistics

Panel A of Table 2 presents descriptive statistics for the samples used for Business Roundtable *Signatory* tests. Around half (50.2%) of the sample has experienced at least one compliance violation. Labor violations are more common relative to environmental violations; 37.2% of firm-years in the sample commit at least one labor violation while 16.1% of firm-years in the sample commit at least one environmental violation. Panel B compares the BRT signatories with the Compustat sample. As shown, BRT signatories are larger and have higher market to book ratios but lower sales growth rates than the average Compustat firm. BRT signatories are relatively very profitable (mean ROA is 0.1342 relative to mean ROA of 0.0132 for average Compustat firm), reflecting their position as among the largest and most established publicly traded firms. BRT signatories are far more levered than the average Compustat firm.

Panel B of Table 2 also illustrates the importance of running our analyses on a matched sample. While BRT signatories differ substantially from the Compustat universe as noted above, our matching approach achieves covariate balance along all dimensions other than sales growth rate. Our matching approach also appears to pair treatment firms to control firms with similar levels of labor intensity; we find no difference in revenues per employee between treatment and control firms (untabulated). Nonetheless, to verify that our results are not driven by the choice of matching approach, in untabulated specifications we match without replacement; our inferences are unchanged.

4.3 E&S record

Table 3 reports the results of estimating equation (1). Column (1) presents the results of estimating a probit model where the dependent variable is the presence of any violation. All regressions estimated in Table 3 include Fama-French 12 industry fixed effects and year

fixed effects. Standard errors are clustered by firm.[9] The coefficient on BRT Signatory, a dummy variable, is positive and significant at conventional levels (0.5206, z-statistic is 4.06). Un-tabulated marginal effects calculations suggest that a BRT signatory is 16.0 percentage points more likely to have committed any violation, as per the Good Jobs First data.[10] Turning to control variables, the following types of firms are more likely to commit violations: firms that are larger, the ones with lower market to book ratios, slower sales growth rates, lower ROAs and higher leverage. Column (2) reports the results of estimating a linear regression related to the logged dollar amount of penalties charged by the Federal agencies and BRT signatories. Again, the coefficient on BRT signatory is positive and significant (coefficient = 2.2155). Columns (3)-(6) suggest that these inferences hold for the incidence of labor and environmental violations and penalties. In particular, looking at marginal effects, columns (3) and (5) suggests that a BRT signatory is 11.7 (9.1) percentage points more likely to have committed a labor (environmental) violation as per the Good Jobs First dataset.

In columns (7) and (8) of Table 3, we assess serious compliance violations. In column (7) we focus on labor lawsuit settlements; the dependent variable is an indicator for whether the firm paid out a major lawsuit settlement for either wage & hour issues or workplace discrimination. As with the compliance data, we obtain this data from *Violation Tracker*.[11] In Column (8), we focus instead on financial compliance; the dependent variable is an indicator for whether the firm either paid out a securities class-action settlement or received an Accounting and Auditing Enforcement Release (AAER) from the Securities and Exchange Commission. As in the case of labor violations, we find that signatory firms are more likely

[9] We do not cluster on both firm and years because of the small number of sample years (Petersen 2009).
[10] When estimating a probit where the independent variable of interest is binary, the appropriate marginal effect to interpret is the change in probability that the dependent variable equals 1 when the binary independent variable moves from 0 to 1.

[11] As of now, the only types of labor lawsuits that *Violation Tracker* provides data on pertain to wage & hour issues and discrimination.

to pay out labor lawsuit settlements. Un-tabulated marginal effects calculations, based on the coefficient of 0.2995 on BRT Signatory, suggest that signatory firms are 3.53 percentage points more likely to settle such lawsuits; this is economically significant in light of the sample mean of 8.6% firm-years having such settlements.[12] In column (8) we find no difference between signatory firms and their matched peers in the likelihood of having been sanctioned for financial reporting issues, suggesting that signatory firms do not outperform their peers in providing truthful, transparent disclosures to investors.

4.4 Does signing the statement signify an intent to improve in the future?

One possible explanation for our results is that signatories of the BRT statement were signaling an intent to change their ways. While we cannot yet test the ex-post compliance records of signatories, we test the ex-ante credibility of this claim by considering whether signatory firms were showing improvement in their compliance practices prior to signing the *Statement*. In Table 4, we re-estimate equation (1) separately for each of the years 2014-2018 and for each violation category (all violations, environmental violations, labor violations). We employ the same control variables as in Table 3 (other than year fixed effects, because all models are estimated within a single year), although for brevity we do not tabulate these. When considering all violations or labor violations, we find evidence that BRT signatories were worse in every year, while we find that BRT signatories had worse environmental compliance records from 2014 through 2016 (and no better in 2017 and 2018). We caution that care should be taken in interpreting the environmental compliance results for 2017 and 2018 because, under Scott Pruitt's leadership, the EPA became significantly more lenient; our results may therefore simply reflect non-enforcement for all firms rather than improved performance for BRT firms, especially when considered alongside our results for other types

[12] The sample size in these two columns is slightly smaller (1,130 observations in column (7) and 970 observations in column (8)) because of perfect separation resulting from industry fixed effects; given our overall sample size of 1,180 firm-years, the dependent variable is always zero in firm-years in certain Fama-French 12 industries, making these fixed effects perfect predictors of the dependent variable.

of violations. Overall, we find little evidence in support of the claim that signing the BRT statement signals an intent to change E&S practices.

4.5 Record related to G

In panel A of Table 5, we assess the record of BRT signatories along five dimensions: (i) the dollars they spend lobbying regulators; (ii) abnormal CEO compensation; (iii) how entrenched the board is; (iv) the guidance they issue on proxy votes; and (v) how concentrated is the market share of the BRT firms? All regressions estimated in Table 5 control for Fama French-12 industry fixed effects and year fixed effects. The data reveal that the governance record of BRT signatories is somewhat mixed. In column (1), the dependent variable is the natural log of one plus lobbying dollars spent by firms; lobbying data is obtained from the Center for Responsible Politics' *OpenSecrets* database. As shown, the coefficient on BRT signatory is positive and significant (coefficient = 2.8245) suggesting that BRT signatories outspend their counterparts in lobbying regulators. This result obtains after controlling for firm size as large firms are known to spend more on lobbying regulators. In terms of the control variables, as expected, slow growing firms and firms with lower market to book ratios spend more on lobbying. Even after controlling for all of these factors, the estimated effect is substantial; our model predicts that BRT signatories spend 16.85 times as many lobbying dollars as non-signatory firms.[13]

In column (2), the dependent variable is log abnormal compensation, measured as actual CEO compensation as per TDC1 in the Execucomp database minus the industry-size

[13] Because OpenSecrets is a comprehensive source of data derived from mandatory federal filings, we treat firm-years for which we do not observe OpenSecrets lobbying data as having spent zero dollars on federal lobbying. If we take a more conservative approach – estimating the model only on the subsample of 827 weighted firm-years for which we observe non-zero lobbying dollars – our results are qualitatively similar but the estimated marginal effect is substantially smaller. In that iteration, we estimate that Business Roundtable signatories spend approximately 2.32 times as much money on lobbying, relative to non-signatory matched firms. This disparity is likely driven by the fact that the proportion of firms with non-zero lobbying amounts is somewhat unbalanced in the BRT and the control samples: 477 out of 590 Business Roundtable signatory firm-years have a nonzero lobbying amount in OpenSecrets while only 350 out of 590 matched control weighted firm-years have a nonzero lobbying amount in OpenSecrets.

quintile median level of compensation.[14] Despite removing the impact of firm size, one of the largest factors affecting compensation, we find that the coefficient on BRT signatory is positive although the p-value is 0.072 (coefficient = 0.4327). Our coefficient estimate suggests that BRT signatories pay 54% higher abnormal compensation relative to non-signatory firms. This may be related to our finding, in column (3), that BRT signatories have a lower percentage of independent directors on their boards relative to peer firms. In column (4), we regress Bebchuk et al. (2009)'s entrenchment index on BRT signatory indicator variable to assess whether the balance of power between shareholders and managers is tilted in favor of management. The entrenchment index is based on six corporate governance characteristics that are thought to limit shareholders' power relative to management (staggered boards, limits to shareholder bylaw amendments, requiring supermajorities for merger approval and charter amendments, and the existence of poison pills and golden parachutes). The value assigned to the index is the number of such provisions a company has; a higher score reflects worse corporate governance via higher managerial entrenchment.

We find, in column (4), no evidence to suggest that BRT signatories are any different from their counterparts on this dimension. Finally, in column (5) we consider management guidance on proxy votes for governance-related proposals. To control for selection effects – i.e., the possibility that some firms systematically receive lower-quality shareholder proposals for which there is limited information content in management's recommendation – we consider the frequency with which BRT signatories contradict the recommendation of Institutional Shareholder Services (ISS). We find that BRT signatories' managements are more likely to recommend votes against governance-related proposals that ISS supports, relative to peer firms.

[14] TDC1 is the sum of an executive's salary, bonus, restricted stock grants, and the value of stock options granted (where value is calculated using the Black-Scholes model).

In panel B of Table 5, we investigate whether BRT signatories are dominant in their product markets. Dominance is measured as industry-level market share, computed at the two and three digit SIC index levels. Because market share is a function of industry-level competition, which can vary within year, we employ industry-by-year fixed effects at the corresponding SIC index level. As can be seen in columns (2) and (3), the coefficient on BRT signatory indicator variable is positive and significant, suggesting that BRT signatories enjoy 0.95% (2.03%) more market share when measured at the two (three) digit SIC code levels. Despite these results, column (3) suggests that BRT signatories have lower operating margins than peer firms while column (4) suggests that BRT signatories have lower Fama-French four-factor alphas (computed using monthly returns over the past 5 years).

In sum, BRT signatories are more likely to have a violation record with more than 50 federal agencies and enforcement divisions relative to their counterparts. In particular, BRT signatories are 9.1% (11.7%) more likely than the matched control sample to have an environmental (labor) violation. BRT signatories spend more on lobbying regulators than their counterparts. They also enjoy larger market shares in their respective three and four digit SIC code based industries than the control sample. CEOs of BRT signatories are likely to be paid more even after controlling for firm size, market to book ratio, leverage, ROA and change in ROA. A collective assessment of the evidence suggests that BRT signatories are not exemplary corporate citizens that "walk the talk" with respect to corporate social responsibility along the dimensions measured in this paper.[15]

4.6 Event study

[15] It is possible that CEOs that sign the BRT are newcomers to their firms seeking to atone for their employers' prior compliance records. This argument is not borne out in the data, however; when including an indicator for new CEOs, as well as an interaction between *BRT signatory* and the new CEO indicator, we find no difference in compliance histories between BRT signatories that changed CEOs during our sample period relative to BRT signatories that did not change CEOs. Moreover, the main effect of the new CEO indicator is positive and significant, suggesting that across our sample (treatment plus matched controls), firms are *more* likely to have compliance violations subsequent to hiring a new CEO.

Because the BRT statement was unexpectedly announced on August 19, 2019 – and drew a significant amount of press coverage on that day itself – in Table 6 we conduct an event study and assess whether the signing of the BRT Statement is associated with cumulative abnormal returns around the announcement date. We consider three event windows for abnormal returns: (0,+1), (-1, +3), and (-3, 15) where in all cases the first number represents the number of trading days before the announcement date and the second represents the number of trading days after the announcement date. In all cases we use an estimation window of (-250, -30), i.e., we consider returns from (approximately) one year to one month before the announcement date. We then regress the relevant cumulative abnormal returns on *BR_Signatory* as well as controls for (log) market capitalization, market to book, leverage, and ROA.

In all three cases, we find no market reaction to the release of the BRT *Statement*. If investors viewed the release of the *Statement* as conveying future information about signatories' plans, we should observe a market reaction (whether positive or negative, depending on whether the commitment to improving all stakeholders' welfare was viewed as value-increasing or value-destructive). The absence of a significant market reaction in Table 6 therefore suggests that market participants agree with the assessment that the BRT statement represents cheap talk.

5.0 ESG Indices

Our second objective in this paper is to assess the extent to which existing indicators of ESG issues used by investors actually reflect underlying ESG performance. This exercise is important because investors, especially asset managers, can hold managers' feet to the fire with respect to potential cheap talk about corporate purpose. We focus on index funds that claim to select only firms with high ESG performance, as these reflect a convenient way for investors to actually "put their money where their mouth is" with respect to ESG issues.

Specifically, we study stock membership and inclusion decisions for the largest ESG ETF and mutual fund, respectively: BlackRock's iShares MSCI KLD 400 Social ETF, which tracks MSCI's KLD 400 social index, and Vanguard's FTSE Russell's FTSE4Good US Select index. After establishing whether ESG indices appear to reflect good underlying ESG practices, we next consider whether index inclusion impacts firms' compliance outcomes. If index inclusion yields a shift in a firm's investor base – whereby a firm included in an ESG index obtains a higher proportion of investors with an explicit preference for "high-ESG" firms – then indexed firms' non-financial practices may be more carefully monitored by such aware investors. An increase in monitoring should lead to an improvement in compliance outcomes because one key cost of misconduct – reputational damage – is higher in expectation when more investors notice.

5.1 Research design related to index membership

As with the Business Roundtable-related tests, we concentrate on compliance violations as a measure of underlying performance. High-ESG firms should treat their employees and the environment better, which should be reflected in a lower rate of compliance violations. To verify this assertion, we test whether firms that are members of ESG indices commit fewer compliance violations relative to non-member peer firms. We focus on membership in the KLD 400 index or the FTSE4Good US Select Index between 2008 and 2018; our sample is limited by the availability of data from RepRisk on ESG-related news, which is used extensively in the tests to follow. Our sample period primarily reflects a time subsequent to the U.S. financial crisis in which ESG investing rose to prominence. We estimate the following probit model:

$$MEMBER_{it+1} = F(\gamma_0 + \gamma_1 VIOLSUM_{it} + \gamma_2 BADNEWS_{it} + \gamma_3 Controls_{it} + Industry_i + \eta_t + \varepsilon_{it}) \quad (2)$$

In equation (2), $MEMBER_{it+1}$ is an indicator that equals 1 if firm *i* is a member of the relevant ESG index in year *t.* The quantity $VIOLSUM_{it}$ is the natural logarithm of one plus the

sum of all fines paid for compliance violations across years *t*, *t*-1, and *t*-2; we use a three-year sum to capture the fact that FTSE Russell and MSCI may consider multiple years of compliance history in taking index membership decisions.

In equation (2), $BADNEWS_{it}$ represents a series of proxies for bad news, compiled using RepRisk's news analytics data. We include this variable because of concerns that commercial ESG ratings are driven by bad news itself rather than events underlying bad news (Yang (2019)). Because ESG index inclusion is heavily driven by such underlying commercial ESG ratings, we expect γ_1 to be statistically insignificant and γ_2 to be negative. In addition, because ESG indices explicitly indicate a focus on large-cap firms in their index methodology documents, we include membership in the S&P 500 index as one of our key control variables.

We estimate equation (2) separately for additions to the KLD 400 index and to the FTSE4Good US Select Index because of the different universes that these two indices are drawn from. The FTSE4Good US Select Index is drawn exclusively from large firms. Hence, we limit the sample to firms in the Russell 1000 at least once during the sample period. By contrast, the KLD 400 is drawn from a much larger sample as MSCI specifically attempts to include small-cap firms in the index. Hence, we consider a much broader control sample, as detailed below.

For our KLD 400-related tests, we limit the sample to firms above a certain size for two reasons. First, Violation Tracker provides violation data at the subsidiary company level, and parent-subsidiary linkages are only available for large firms. Second, RepRisk's news analytics data is primarily available for larger firms. For example, the first percentile of firms (by total assets) with at least one negative news event during RepRisk's coverage period has over $250 million in total assets and the median firm covered by RepRisk has $1.69 billion in total assets. We therefore impose a size-related screen that considers only firm-years with

over $750 million in total assets. This cutoff approximates a point at which we can be confident that Good Jobs First and RepRisk's coverage is complete – meaning that the absence of a violation in *Violation Tracker* or absence of an incident in RepRisk genuinely reflects the fact that no violation was detected or no ESG-related bad news occurred, respectively. We verify in un-tabulated tests that our results are not sensitive to the precise choice of cutoff. Details of the process followed to identify our sample for the two index membership tests are reported in panels B and C of Table 1, respectively.

5.2 Results related to index membership

Table 7 presents results of estimating equation (3) using a probit specification. All estimations include Fama-French 12 industry and year fixed effects and standard errors are clustered by firm.[16] In columns (1)-(4), the dependent variable is an indicator variable for whether a stock is a member of the KLD 400 index in year t+1 (relative to independent variables, which are all measured at time t), while in columns (5)-(8), the dependent variable is instead an indicator variable for whether a stock is a member of the FTSE4Good US Select Index. Columns (3), (4), (7), and (8) include controls for various categories of bad news pertaining to the firm, as measured by RepRisk, as well as CSR scores from MSCI. We find no association between membership in the KLD400 index and the three-year sum of federal compliance penalties when considering all types of violations together in column (1). When we consider labor and environmental penalties separately, we find a negative association between membership in the KLD400 index and fines paid for environmental violations over the past three years, relative to the control sample in column (2). However, there is no

[16] Even though we use a probit specification, we add industry and year fixed effects to account for systematic industry or year-level variation. One potential risk with including fixed effects that are too granular is that we would drop all observations for which there is no variation in the dependent variable within an industry group (the perfect separation problem). Hence, we use Fama-French 12 industry fixed effects rather than something more granular; if we were to use, for instance, industry fixed effects based on SIC classification, we would likely drop observations. Also note that clustered standard errors in a probit model are similar to clustered standard errors in a linear model (see Cameron and Miller (2015), or Wooldridge (2006, available here: https://pdfs.semanticscholar.org/ebcb/e37f03a030e63828bf0b761f9ef957d9fbb8.pdf)).

difference between KLD400 index members and non-member control firms with respect to labor violations.[17]

This finding continues to hold even after controlling for bad ESG-related news based on RepRisk classifications and MSCI's proprietary CSR scores; we find in columns (3) and (4) that firms that face bad publicity pertaining to the environment, corruption, and human rights issues are less likely to be members of the KLD400 index (although there is no link between labor-related publicity and KLD400 index membership). We also find strong evidence that firms with higher CSR scores are more likely to be members of the KLD400 index. KLD400 index members are more likely to be part of the S&P 500 and larger. They are also likely to be stocks with higher market-to-book but lower annual returns.

When considering the FTSE4Good US Select Index, our main result is opposite to those reported above for the KLD400 index. Specifically, while we continue to find no link between the three-year sum of compliance penalties and index membership in column (5) of Table 7, in column (6) we find that labor – but not environmental – violations predict a lower likelihood of FTSE4Good US Select Index membership.[18] These results continue to hold even after controlling for bad ESG-related news and MSCI's proprietary CSR scores in columns (7) and (8).

5.3 Research design related to index changes

Given the mixed nature of our findings in Section 5.2, and the fact that ESG index membership is by the index creators' design quite sticky, we attempt to better understand our results by studying index addition and deletion decisions. For example, if a firm is in an ESG index in year t and was added to the index in year $t - 3$, the primary determinant of the firm's

[17] Our results are not substantially different if we instead use a five-year sum; we prefer the three-year, rather than five-year sum because it imposes less stringent data requirements (and thus yields a larger sample size).
[18] When using a five-year sum, we in fact find no relation between *any* type of compliance history and FTSE4Good US Select Index membership.

year *t* membership is likely the firm's year *t* – 3 characteristics. Moreover, firms added to ESG indices are directly compared by MSCI and FTSE (the index creators) against competing peers. Such a zero-base active comparison may not occur for firms already in ESG indices, i.e., prior inclusion in the respective indices may not be informative about whether an ESG-conscious individual should trust index providers with making good *future* investment decisions. We therefore focus on the decisions made by MSCI and FTSE Russell concerning which firms to add to their respective indices in a given year; if the firms being added to ESG indices truly exhibit superior ESG performance relative to other potential candidates for index inclusion, we should observe a negative relation between environmental or labor violations and the likelihood of index addition. To do so, we estimate the following probit models:[19]

$$ADDED_{it+1} = F(\gamma_0 + \gamma_1 VIOLSUM_{it} + \gamma_2 BADNEWS_{it} + \gamma_3 Controls_{it} + Industry_i + \eta_t + \varepsilon_{it}) \quad (3)$$

$$DELETED_{it+1} = F(\gamma_0 + \gamma_1 VIOLSUM_{it} + \gamma_2 BADNEWS_{it} + \gamma_3 Controls_{it} + Industry_i + \eta_t + \varepsilon_{it}) \quad (4)$$

where $ADDED_{it+1}$ is an indicator for whether firm *i* was added to one of the ESG indices in year *t* + 1 (but *was not* a member of the ESG index in year *t*) and $DELETED_{it+1}$ is an indicator for whether firm *i* was deleted from one of the ESG indices in year *t*+1 (but *was* a member of the ESG index in year *t*). $VIOLSUM_{it}$ is constructed in the same way as in our index membership tests outlined in equation (2). For the same reasons as in our index membership tests, we estimate equations (3) and (4) separately for additions to the KLD 400 index and to the FTSE4Good US Select Index because of the different universes that these two indices are drawn from.

[19] In untabulated alternative specifications we also estimate hazard models of index addition and deletion in lieu of equations (3) and (4). Our inferences do not change.

In estimating equation (3), we limit the sample to firms not in the respective indices in year *t* because index addition decisions are only made for firms not already in the index. Similarly, in estimating equation (4) we limited the sample to firms in the respective indices in year *t* because it is only possible to delete a firm that was previously in the index. To identify index additions (and deletions), we obtain month-end index constituent data for both the KLD400 and FTSE4Good US Select index. We hand-collect the KLD400 constituent lists from BlackRock's iShares webpage, while we obtain FTSE4Good index constituents from CRSP. In our final usable regression sample, spanning index additions between 2008 and 2018 (and independent variables between 2007 and 2017), we observe 224 additions to the KLD400 and 185 additions to the FTSE4Good US Select index. We also observe 163 deletions from the KLD400 and 145 deletions from the FTSE4Good US Select index (where a "deletion" represents us observing financial data for a firm in year *t* and year *t*+1, as well as index membership in year *t* but not in year *t*+1).[20]

Although we test for the determinants of deletions, some caution is required in interpreting our findings because of the grace period offered to firms whose CSR ratings fall below acceptable standards prior to deletion. The presence of this grace period – the length of which is publicly undisclosed at the individual deletion level – makes it difficult to accurately link the timing of a deletion with the timing of underlying events that cause such deletion. As in the case of the index membership tests detailed in Sections 5.1 and 5.2, we estimate our FTSE4Good US Select and KLD400 addition tests on different subsamples to reflect both data availability and the different firm universes considered by FTSE Russell and MSCI.

5.4 Results related to index additions and deletions

5.4.1 KLD 400 index additions

[20] The number of "deletions" from the KLD400 does not match the number of additions because many firms removed from the KLD400 are those that merge or privatize; we do not observe year-*t*+1 financial information for such firms.

As can be seen in column (1) of Table 8, there is no association between additions to the KLD400 index and any federal violation in general and any labor and environmental violation in particular relative to the control sample. Somewhat predictably, additions are larger firms (coefficient on log market value is 0.1718 in column 1). That is, KLD 400 additions are not special with respect to their corporate social responsibility, as measured by incidence in the Violation Tracker, relative to the control sample.

One explanation for the findings in columns (1) and (2) is that ESG index addition could primarily reflect good corporate governance (the "G" in ESG). To test this explanation, in columns (3) and (4) we add two common proxies for corporate governance, excess compensation and board independence. Excess compensation does not appear to inhibit index addition while, perhaps more surprisingly, firms with a *lower* percentage of independent directors are more likely to be added to the KLD 400. These results suggest that KLD 400 index addition is not driven by strong corporate governance.

This finding naturally raises the question related to what actually drives additions to the KLD 400 index. As mentioned before, we conjecture that the trigger is merely negative media mentions of a firm related to ESG activities. To verify that conjecture, we add an indicator variable related to the incidence of negative news related to labor, environment, corruption or human rights about the firm in the RepRisk database. Columns (5) and (6) suggest a slight negative correlation between firms added to the KLD400 index and negative environmental news.

Columns (7) and (8) presents perhaps the most interesting variation. Here, we find that the strongest explanatory factor behind the addition of a firm to the KLD 400 index is the CSR score from MSCI (coefficient on CSR score = 0.0105 in column 7). There is mild correlation between such additions and negative environmental and human rights news associated with the company. Note that the number of firm-year observations used in

columns (7) and (8) is far lower in the other two columns because imposing the filter related to the presence of a CSR score from MSCI shrinks the sample to 9,067 firm year observations. Curiously, negative environmental and human rights news explains the dependent variable, additions to the index, suggesting that the KLD400 index creators consider media stories in addition to the MSCI CSR index while deciding which stocks to add.

In sum, it appears as though additions to the KLD 400 index are driven primarily by a high CSR score assigned by MSCI. Remarkably, additions to the KLD 400 index are not directly correlated one way or the other with the firm's violation record with federal authorities relative to a control sample. There are traces of correlations between additions to the index and negative compliance news as per the RepRisk database.

5.4.2 FTSE4Good U.S. Select Index additions

Panel B of Table 8 repeats the exercise with additions of stocks to the FTSE4Good U.S. Select Index in columns (1), (3), (5) and (7). As with the KLD 400 sample, we find that firms added to the FTSE4Good U.S. Select Index are likely to be no different from the control sample with respect to their violation records, whether we consider all violations or labor and environmental violations individually. We also find, as with the KLD 400 sample, that excess compensation is uncorrelated with index addition while firms with a lower percentage of independent directors are actually more likely to be added to the FTSE4Good U.S. Select Index (see columns 3 and 4). Turning to the control variables, large and levered firms and S&P 500 members are more likely to be added.

Columns (5) and (6) suggest an association between negative news related to corruption activities as per RepRisk. However, firms' federal compliance records do not explain additions to the FTSE4Good U.S. Select Index regardless of whether we control for bad news about the firm's ESG record. Perhaps not surprisingly, the CSR score provided by

MSCI, a potential rival to FTSE Russell, does not explain additions of stocks to the FTSE4Good US Select Index (even though we do find a cross-sectional correlation between FTSE4Good US Select index *membership* and MSCI's CSR scores in Table 7). Because of the limited coverage of MSCI's CSR scores, the sample shrinks to 5,449 firm-year observations.

In sum, we find almost no evidence that additions to either of the major ESG indices considered reflect federal violation records. The results in Tables 7 and 8 raise questions about how index creators screen for firms with superior ESG performance. Another possibility, however, may be that the index membership results in Table 7 reflect a monitoring effect, whereby index inclusion leads to better ESG performance *subsequent to* index inclusion; we explore this possibility in Section 5.5.

5.4.3 Index Deletions

In Table 9, we turn to index deletions. We present results for deletions from the KLD400 index in Panel A, while results for deletions from the FTSE4Good US Select index are in Panel B. We omit deletions that result from the firm itself ceasing to be publicly traded, i.e., de-listing. In Panel A we find, remarkably, that the *only* factor explaining deletions from the KLD400 index is MSCI's proprietary CSR score. The negative coefficient suggests that firms with lower CSR scores are likely to be removed from the KLD400. As with the case of index additions, we find no link between compliance history and removal from the KLD400.

Turning to the FTSE4Good US Select Index, we find in Panel B that removals appear to primarily reflect negative news coverage related to environmental issues as well as size and financial performance: there is a negative correlation between deletion and both firms' market values and their market-to-book ratios. Firms with higher within-year returns volatility are also more likely to be removed. However, we find no relation between FTSE4Good US Select Index deletion and the firm's violation record with federal authorities

relative to a control sample. These results are consistent with the FTSE4Good US Select Index's stated exclusionary screening practices, based on firm size and the existence of "significant controversies." Nonetheless, they underscore our broader finding that ESG index additions and deletions do not appear to reflect "fundamental" ESG practices.

5.5 Research design related to future compliance outcomes

The absence of meaningful change in underlying past fundamentals suggests the possibility that index addition potentially anticipates better fundamentals in the future. To verify whether this is the case, we estimate a staggered difference-in-differences model where we estimate the effect of being added to an ESG index on subsequent compliance outcomes.

As with the Business Roundtable sample, it is important that we choose an appropriate control sample. We rely on propensity score matching, based on the ESG index addition model outlined in equation (3). Index creators do not employ quotas for specific industries. Thus, in order to better reflect the decision-making process underlying index addition, we do not match within industry (although we do include industry indicators in the matching model). We do match within-year, i.e., we match a treatment firm in year *t* against an appropriate control firm based on that control firm's characteristics in year *t* and retain that same treatment-control match throughout the sample. We employ a sample period of 2007-2017 to match our tests outlined in Sections 5.1 and 5.3.

Using this matched sample, we conduct several tests to determine whether ESG index addition appears to be correlated with future compliance violations. The staggered difference-in-differences design that we estimate is:

$$VIOLATION_{it} = \alpha_0 + \sum_{j=0}^{11} \beta_j \cdot ADDED_{i,t-j} + \alpha_1 \cdot Controls_{it} + \theta_i + \delta_t + \varepsilon_{it} \quad (4)$$

where $VIOLATION_{it}$ is an indicator variable that equals 1 when firm *i* commits at least one federal compliance violation in year *t* and $ADDED_{i,t-j}$ are a series of indicator variables that

equals 1 if firm *i* is added to *either* the FTSE4Good or KLD 400 index in year $t - j$ after having been a member of neither. The indicator variables $ADDED_{i,t-j}$ represent the product of the treatment and post-period variables in the difference-in-differences as the main treatment and time effects are subsumed by firm and year fixed effects θ_i and δ_t, respectively. That is, if firm *i* is added to an ESG index in 2013 and not removed from the index during our sample period, $ADDED_{i,t-1}$ equals 1 for that firm only in 2014 (but not in any other year), $ADDED_{i,t-2}$ equals 1 for that firm only in 2015, and so on. In an alternative specification (un-tabulated) we impose a stricter condition by only setting $VIOLATION_{it} = 1$ if firm *i* incurs at least $50,000 in cumulative penalties for compliance violations in year *t*. If ESG index membership is correlated with fewer future violations, then we should observe negative β_j coefficients.

Tables 10 and 11 compile the "fundamental" ESG record of stocks added to the FTSE4Good US Select or KLD 400 index. For brevity we only tabulate coefficients for $ADDED_{i,t-0}$ through $ADDED_{i,t-5}$ (although we include all relevant indicators in the underlying estimation of equation (4)). In particular, Table 10 reports correlations between stocks added and environmental and social federal violations whereas Table 11 considers proxies for corporate governance. Remarkably, there is nearly no correlation between federal violation records and stocks added. In particular, firms added to an ESG index subsequently appear to be no different from the control sample in terms of the overall likelihood of being sanctioned for violations of federal law, as shown in column (1) of Table 10. Moreover, stocks added to an ESG index are no different from the control sample in terms of (i) total fines levied, as shown in column (2); (ii) the overall likelihood of being sanctioned for violations of labor or environmental law, as shown in columns (3) and (5); and (iii) fines specifically for environmental violations, as shown in column (6). Additionally, in column

(4) we find some evidence that firms added to an ESG index pay *higher* fines for labor violations subsequent to ESG index inclusion.

In Table 11, we again observe almost no association between standard proxies for corporate governance (board independence, abnormal CEO compensation, Bebchuk et al. (2009) entrenchment index) and stocks added; in fact, we find that in the years after being added to an ESG index, firms *decrease* the percentage of independent directors on their boards. Firms added to ESG indices also do not appear to change their behavior regarding political connections, as there is no effect of ESG index addition on lobbying behavior. In sum, Tables 10 and 11 suggest that additions to the FTSE4Good or KLD 400 index are not associated with firms' underlying ESG records, along the dimensions measured in this paper.

Our results in Tables 7-11 suggest that there is no robust relation between a firm's compliance record and ESG index addition or deletion. However, one explanation for our findings is that index providers often develop proprietary ESG ratings and build indices off these ratings. If proprietary ratings drive index inclusion decisions, then directly estimating the link between index inclusion and compliance record may not pick up indirect effects of a firm's compliance record on the likelihood of ESG index addition. Hence, we directly estimate the link between MSCI's proprietary CSR ratings and firms' compliance history. Results from these tests are presented in Table 12. We find that federal violations, whether considered collectively (columns (1) and (3)) or broken down into environmental and labor violations (columns (2) and (4)) do not appear to negatively influence CSR scores issued by MSCI. In column (2) we even find that CSR scores are *higher* when labor violations occur, although this result disappears when we control for lagged CSR score. These results further support our finding that compliance records do not appear to be correlated with index addition or deletion decisions.

6. Conclusions

In this paper, we attempt to verify whether the ideals related to environmental, social and governance espoused by signatories to the 2018 letter from the Business Roundtable (BRT) are matched by their "fundamentals" based track record. We perform a similar validation exercise for stocks in the largest ESG ETF and mutual fund, respectively: BlackRock's iShares MSCI KLD 400 Social ETF, which tracks MSCI's KLD 400 social index, and Vanguard's FTSE Russell's FTSE4Good US Select index. The "fundamentals" data comes from the Violation Tracker database, compiled by the non-profit organization Good Jobs First. Violation Tracker provides comprehensive coverage of violations of federal laws written by over 50 US federal agencies, especially those related to labor and the environment. Although we provide a few suggestive tests with respect to "G" in ESG, our governance data is admittedly not as comprehensive as our data on "E" and "S." We find that Business Roundtable signatories exhibit worse records with respect to labor and the environment than their peers. We find no stock market reaction to the announcement of the *Statement* suggesting that investors do not perceive the *Statement* as a true commitment to improve ESG practices in the future. Finally, we find no evidence that firms' fundamental records with respect to "E" and "S" predict their inclusion in key mutual funds that purport to be ESG-oriented.

A combined reading of the evidence presented in the paper suggests that the correlation between the self-proclaimed high ESG companies, both in the BRT and the stocks added to ESG funds examined, and their records in Violation Tracker is under-whelming. These results raise several questions about whether declaration of high minded ideals by firms is cheap talk and whether commercially available ESG ratings really capture a firm's ESG orientation. Much remains to be explored in follow up work.

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APPENDIX A: Violation Tracker composition

The federal violations that comprise the *Violation Tracker* database are as follows:

(1) Settlements announced in press releases related to the Agricultural Marketing Service;
(2) Export violations and anti-boycott violations as per the Bureau of Industry and Security;
(3) Civil penalties imposed by the Bureau of Safety and Environmental Enforcement;
(4) Medicare Coverage Gap Discount Program violations, Medicare Parts C&D Enforcement Actions since 2010 and Nursing Home Compare penalty data per the Centers for Medicare & Medicaid Services;
(5) Resolved case announcements of the Commodity Futures Trading Commission;
(6) Resolved case announcements since the Consumer Financial Protection Bureau agency began operation in 2011;
(7) Civil penalties announced in press releases of the Consumer Product Safety Commission;
(8) Resolved case announcements involving pharmacies by the Drug Enforcement Administration;
(9) Clery Act penalty notices of the Education Department;
(10) Resolved case announcements in press releases of the Employee Benefits Security Administration; penalty assessments of the Employee Benefits Security Administration;
(11) Enforcement actions of the Energy Department Office of Enforcement;
(12) Energy conservation enforcement actions of the Energy Department Office of General Counsel;
(13) Civil cases and settlements, criminal prosecutions, enforcement and compliance history Online (ECHO) enforcement case search, ECHO Integrated Compliance Information System (ICIS FE&C), environmental crimes monthly bulletin, press release announcements of case resolutions of the Environmental Protection Agency;
(14) Resolved case announcements in press releases of the Equal Employment Opportunity Commission;
(15) Quarterly enforcement reports of the Federal Aviation Administration;
(16) Announcements of enforcement actions of the Federal Communications Commission;
(17) Enforcement decisions of the Federal Deposit Insurance Corporation;
(18) Civil penalty actions since 2007 and resolved case announcements in press releases since 2001 by the Federal Energy Regulatory Commission;
(19) Resolved lawsuits against investment banks by the Federal Housing Finance Agency;
(20) Penalties announced in press releases by the Federal Maritime Commission;
(21) Civil penalties since 2005 of the Federal Motor Carrier Safety Administration;
(22) Annual enforcement reports of the Federal Railroad Administration;
(23) Enforcement actions of the Federal Reserve;
(24) Resolved case announcements of the Federal Trade Commission;
(25) Penalties announced in press releases at Food and Drug Administration;
(26) Enforcement actions of Grain Inspection, Packers & Stockyards Administration;
(27) Settlements announced in press releases of Health and Human Services Department Office for Civil Rights;
(28) Civil monetary penalties since 2001 issued by Health and Human Services Department Office of Inspector General;
(29) Civil monetary penalties issued by Housing and Urban Development Department;
(30) Settlements announced in press releases of the Housing and Urban Development Department;
(31) Civil penalties of the Interior Department Office of Natural Resources Revenue;
(32) Section 337 cease-and-desist-order violations by International Trade Commission;

(33) Settlements and verdicts announced in press releases by Justice Department Antitrust Division, Justice Department Civil Division, Justice Department Civil Rights Division and by the Justice Department Criminal Division;
(34) Foreign Corrupt Practices Act declinations issued by the Justice Department Criminal Division;
(35) Settlements and verdicts announced in press releases by Justice Department Environment and Natural Resources Division, Justice Department National Security Division, Justice Department Office of Public Affairs, Justice Department Tax Division, Justice Department U.S. Attorney's Offices and by the Justice Department U.S. Trustee Program;
(36) Settlements announced in press releases of the Labor Department Office of Workers' Compensation Programs;
(37) Compliance action dataset and enforcement actions announced in press releases of the Labor Department Wage and Hour Division;
(38) Settlements announced in press releases and violations data of the Labor Department Wage and Hour Division of the Mine Safety & Health Administration;
(39) Settlements with investment banks of the National Credit Union Administration;
(40) Board-mandated back-pay awards in unfair labor practice cases (obtained through a FOIA request to the National Labor Relations Board;
(41) Civil penalties charged by the National Highway Traffic Safety Administration;
(42) Fuel economy (CAFE) penalties charged by the National Highway Traffic Safety Administration;
(43) Significant enforcement actions of the Nuclear Regulatory Commission;
(44) Corporate settlement agreements, enforcement data, recent enforcement cases with initial penalties above $40,000, whistleblower cases announced in press releases since 2005 at the Occupational Safety & Health Administration (OSHA);
(45) Financial conciliation agreements and settlements announced in press releases of Office of Federal Contract Compliance Programs;
(46) Civil penalties since 2003 at Office of Foreign Assets Control;
(47) Enforcement actions at the Office of the Comptroller of the Currency;
(48) Cases involving civil penalties since 2002 at Pipeline and Hazardous Materials Safety Administration;
(49) Accounting and auditing enforcement releases, administrative proceedings, litigation releases and resolved case announcements at the Securities and Exchange Commission (SEC);
(50) Penalty agreements at State Department Directorate of Defense Trade Controls;
(51) Enforcement orders at Transportation Department Aviation Consumer Protection Division;
(52) Offers in compromise at the Treasury Department Alcohol and Tobacco Tax and Trade Bureau; and
(53) Enforcement actions at Treasury Department Financial Crimes Enforcement Network.

APPENDIX B: Variable Definitions

Variable	Definition
Any compliance violation (indicator)	Indicator that equals 1 if firm *i* had at least one compliance violation (regardless of the penalizing agency or fine amount) in year *t*
Environmental violation (indicator)	Indicator that equals 1 if firm-year had at least one environmental compliance violation (i.e., violations issued by the Bureau of Safety and Environmental Enforcement (BSEE); Department of Energy (DOE); Environmental Protection Agency (EPA); Federal Energy Regulatory Commission (FERC); Fish and Wildlife Service (FWS); National Oceanic and Atmospheric Administration (NOAA); Nuclear Regulatory Commission (NRC); Office of Natural Resources Revenue (ONRR); Pipeline and Hazardous Materials Safety Administration (PHMSA); and US Department of Agriculture (USDA)), regardless of fine amount
Labor violation (indicator)	Indicator that equals 1 if firm-year had at least one labor-related compliance violation (i.e., violations issued by the Employee Benefits Security Administration (EBSA), Equal Employment Opportunity Commission (EEOC), Federal Motor Carrier Safety Administration (FMCSA), Federal Railroad Administration (FRA), Department of Health & Human Services Office of Inspector General (HHSOIG), Mine Safety & Health Administration (MSHA), National Labor Relations Board (NLRB), Occupational Safety and Health Administration (OSHA), and Department of Labor Wage & Hour Division (WHD)), regardless of fine amount
Log total compliance violation $	Log total (firm-year) dollar value of fines assessed for compliance violations
Log environmental violation $	Log total (firm-year) dollar value of fines assessed for environmental violations
Log labor violation $	Log total (firm-year) dollar value of fines assessed for labor violations
Log executive compensation (using Execucomp's TDC1)	Log of total CEO compensation, treating options based on their value at the time of award
Abnormal executive compensation	Difference between log executive compensation and median log executive compensation within same size quintile and Fama-French 12 industry (quintiles are computed within-industry)
Market share (4-digit SIC)	Ratio of firm's sales to total sales for all firm-years in same 4-digit SIC code.
Market share (3-digit SIC)	Ratio of firm's sales to total sales for all firm-years in same 3-digit SIC code.
Market share (2-digit SIC)	Ratio of firm's sales to total sales for all firm-years in same 2-digit SIC code.
Alpha	Estimated using monthly returns, based on the Fama-French four factor model
Business roundtable signatory	Indicator that equals 1 if firm *i* was a signatory of the August 2019 Business Roundtable *Statement on the Purpose of a Corporation*
Log market value	Log of company's market value of equity
Market to book ratio	Ratio of market value of equity to book value of equity, obtained from Compustat
Log sales growth	Log of ratio of current-year sales to prior-year sales
ROA	Ratio of EBITDA to lagged assets
Change in ROA (t-1 to t)	ROA minus previous-year ROA
Leverage	Ratio of (long-term debt + debt in current liabilities) to shareholders' equity
Log lobbying dollars	Log of total firm-year level dollars spent on lobbying, summed across all issues the firm lobbied on, as documented by OpenSecrets
Entrenchment index	Bebchuk et al. (2009) entrenchment index
% independent directors	Percent of the firm's directors that are characterized as independent, obtained from BoardEx database
RepRisk negative labor news (indicator)	Indicator that equals 1 if firm had at least one negative news article pertaining to its labor practices in a media outlet with "medium" or "high" reach, where the media outlet's reach is classified by RepRisk
RepRisk negative environmental news (indicator)	Indicator that equals 1 if firm had at least one negative news article pertaining to its environmental practices in a media outlet with "medium" or "high" reach, where the media outlet's reach is classified by RepRisk

RepRisk negative anticorruption news (indicator)	Indicator that equals 1 if firm had at least one negative news article pertaining to corruption (e.g., foreign bribery) in a media outlet with "medium" or "high" reach, where the media outlet's reach is classified by RepRisk
RepRisk negative human rights news (indicator)	Indicator that equals 1 if firm had at least one negative news article pertaining to human rights violations in a media outlet with "medium" or "high" reach, where the media outlet's reach is classified by RepRisk
S&P 500 indicator	Indicator that equals 1 if firm *i* was a member of the S&P 500 in year *t*
Annual returns	Fiscal-year buy and hold returns
Annual return volatility	Standard deviation of fiscal-year daily returns

TABLES

Table 1: Sample Selection

This table outlines how we arrive at our final regression sample in our tests concerning Business Roundtable signatories and ESG index additions. The starting sample for the Business Roundtable tests is the set of all firms that signed the *Statement;* we obtain financial and compliance data for the five fiscal years prior to the release of the *Statement* (2014-2018) and then add in control firms from Compustat based on size, market to book, and industry. The starting sample for the ESG index tests is the set of all Compustat firms from 2010 to 2017 which, over the sample period, had median year-end total assets of at least $750 million.

Panel A: Business Roundtable sample

Description	Unique firms deleted/added	Unique firms remaining	Firm-years deleted/added	Firm-years remaining
Business Roundtable signatories, 2014-2018		183		915
Less: privately held signatories	(26)	157	(130)	785
Less: publicly traded signatory firms with missing Compustat or CRSP data for at least one year between 2014 and 2018	(39)	118	(195)	590
Plus: control sample, matched on 2018 size and market to book ratio, within industry	81	**199**	590	**1,180**
[For CEO compensation tests only] Less: Firms with executive compensation data unavailable in ExecuComp	(25)	**174**	(196)	**984**

Panel B: KLD 400 Index Membership sample

We outline below the sample selection procedure for our KLD400 index-related test, where we test whether negative compliance outcomes – reflecting, e.g., poor labor or environmental practices – affect the likelihood of inclusion in MSCI's KLD 400 Social Index.

Description	Unique firms deleted/added	Unique firms remaining	Firm-years deleted/added	Firm-years remaining
Compustat firms with within-firm sample median total assets over $750 million, 2007-2017		3,165		24,055
Less: firm-years with missing Compustat or CRSP data	(468)	**2,697**	(4,405)	**19,650**

Panel C: FTSE4Good US Select Index Addition sample

We outline below the sample selection procedure for our FTSE4Good index-related test, where we test whether negative compliance outcomes – reflecting, e.g., poor labor or environmental practices – affect the likelihood of inclusion in FTSE Russell's FTSE4Good US Select Index.

Description	Unique firms deleted/added	Unique firms remaining	Firm-years deleted/added	Firm-years remaining
Firms in the Russell 1000 at any point between 2007 and 2017		1,578		13,312
Less: firm-years with missing Compustat or CRSP data	(194)	**1,384**	(2,230)	**11,082**

Table 2: Descriptive Statistics

This table presents descriptive statistics for the subsamples that we use in our Business Roundtable-related tests and in our ESG index addition tests.

Panel A: Business Roundtable sample and control firms

We present descriptive statistics for the main (propensity score-matched) sample used in our tests concerning the characteristics and compliance outcomes.

Variable	***N***	**Mean**	**Median**	**Std. Dev**	**Q1**	**Q3**
Any compliance violation (indicator)	1,180	0.502	1.000	0.500	0.000	1.000
Environmental violation (indicator)	1,180	0.161	0.000	0.368	0.000	0.000
Labor violation (indicator)	1,180	0.372	0.000	0.484	0.000	1.000
Labor lawsuit (indicator)	1,180	0.086	0.000	0.280	0.000	0.000
AAER or securities lawsuit (indicator)	1,180	0.042	0.000	0.200	0.000	0.000
Log total compliance violation $, conditional on violation occurrence	592	13.077	12.307	3.234	10.356	15.548
Total compliance violation $ (thousands), conditional on violation occurrence	592	102,658	221	1,151,547	31	5,654
Log environmental violation $, conditional on violation occurrence	190	11.886	11.502	2.271	10.309	13.034
Environmental violation $ (thousands), conditional on violation occurrence	190	6,219	99	35,647	30	458
Log labor violation $, conditional on violation occurrence	439	10.556	10.195	1.595	9.426	11.257
Labor violation $ (thousands), conditional on violation occurrence	439	427	27	4105	12	77
Log executive compensation (based on Execucomp's TDC1)	984	9.136	9.338	1.539	8.950	9.727
Executive compensation (based on Execucomp's TDC1; in thousands of $)	984	12,570	11,350	7,996	7,706	16,733
Log lobbying dollars, conditional on non-zero lobbying	827	14.188	14.304	1.492	13.305	15.384
Total lobbying dollars (thousands of $), conditional on non-zero lobbying	827	3,323	1,630	4,039	600	4,801
Fraction independent directors	922	0.701	0.688	0.102	0.643	0.733
Market share (based on 4-digit SIC)	1,180	0.239	0.130	0.271	0.043	0.335
Market share (based on 3-digit SIC)	1,180	0.178	0.093	0.232	0.025	0.217
Market share (based on 2-digit SIC)	1,180	0.069	0.023	0.116	0.007	0.073
Alpha (using monthly returns)	1,180	-0.002	-0.002	0.001	-0.002	-0.001
Business roundtable signatory	1,180	0.500	0.500	0.500	0.000	1.000
Log market value	1,180	10.156	10.201	1.426	9.169	11.203
Market value (millions of $)	1,180	62,153	26,924	95,574	9,597	73,335
Market to book ratio	1,180	4.631	3.266	11.237	1.910	5.846
Log (1+sales growth rate)	1,180	0.060	0.051	0.176	-0.012	0.125
Sales growth rate	1,180	0.080	0.052	0.218	-0.012	0.133
ROA	1,180	0.144	0.133	0.083	0.090	0.183
Change in ROA (t-1 to t)	1,180	0.003	0.001	0.069	-0.010	0.016
Leverage	1,180	1.326	0.805	3.032	0.425	1.496

Panel B: Business Roundtable signatories vs. non-signatories

This panel compares Business Roundtable signatories against two groups of firms: (i) propensity score-matched control firms, and (ii) the full set of Compustat firm-years for our sample period without missing data for any of our control variables.

Variable	Full Compustat sample, less BRT signatories (n=18,333)	BRT signatories (n=590)	Difference	t-stat
Log market value	6.5296	10.247	3.7136***	30.31
Market to book	2.9398	4.6978	1.7102**	2.34
Log sales growth	0.0788	0.0376	-0.0397***	-5.43
ROA	0.0179	0.1342	0.1134***	13.71
Change in ROA	0.0132	0.0002	-0.0129***	-4.64
Leverage	0.7957	1.4783	0.6481***	3.54

Variable	Propensity score matched sample (n=590)	BRT signatories (n=590)	Difference	t-stat
Log market value	10.0656	10.247	0.1814	0.82
Market to book	4.5645	4.6978	0.1333	0.10
Log sales growth	0.083	0.0376	-0.0454***	-2.82
ROA	0.1538	0.1342	-0.0196	-1.65
Change in ROA	0.005	0.0002	-0.0048	-1.56
Leverage	1.1731	1.4783	0.3052	0.85

Panel C: KLD 400 Index Membership Tests

Variable	*N*	Mean	Median	Std. Dev	Q1	Q3
KLD 400 index member	19,650	0.178	0.000	0.382	0.000	0.000
Any compliance violation (indicator)	19,650	0.241	0.000	0.428	0.000	0.000
Environmental violation (indicator)	19,650	0.181	0.000	0.385	0.000	0.000
Labor violation (indicator)	19,650	0.060	0.000	0.238	0.000	0.000
RepRisk negative labor news (indicator)	19,650	0.041	0.000	0.198	0.000	0.000
RepRisk negative environmental news (indicator)	19,650	0.098	0.000	0.298	0.000	0.000
RepRisk negative anticorruption news (indicator)	19,650	0.045	0.000	0.207	0.000	0.000
RepRisk negative human rights news (indicator)	19,650	0.080	0.000	0.271	0.000	0.000
S&P 500 indicator	19,650	0.228	0.000	0.420	0.000	0.000
Log market value	19,650	7.671	7.662	1.734	6.614	8.761
Market to book ratio	19,650	2.607	1.823	7.017	1.147	3.123
Leverage	19,650	1.133	0.701	2.609	0.304	1.377
ROA	19,650	0.116	0.108	0.109	0.038	0.167
Annual returns	19,650	0.137	0.092	0.590	-0.128	0.315
Annual return volatility	19,650	0.025	0.021	0.017	0.015	0.030

Panel D: FTSE4Good US Select Index Membership Tests

Variable	*N*	Mean	Median	Std. Dev	Q1	Q3
FTSE4Good index member	11,082	0.278	0.000	0.448	0.000	1.000
Any compliance violation (indicator)	11,082	0.324	0.000	0.468	0.000	1.000
Environmental violation (indicator)	11,082	0.243	0.000	0.429	0.000	0.000
Labor violation (indicator)	11,082	0.087	0.000	0.282	0.000	0.000
RepRisk negative labor news (indicator)	11,082	0.063	0.000	0.244	0.000	0.000
RepRisk negative environmental news (indicator)	11,082	0.144	0.000	0.351	0.000	0.000
RepRisk negative anticorruption news (indicator)	11,082	0.071	0.000	0.257	0.000	0.000
RepRisk negative human rights news (indicator)	11,082	0.119	0.000	0.324	0.000	0.000
S&P 500 indicator	11,082	0.403	0.000	0.491	0.000	1.000
Log market value	11,082	8.563	8.420	1.360	7.705	9.355
Market to book ratio	11,082	3.493	2.470	9.060	1.467	4.260
Leverage	11,082	0.967	0.594	2.635	0.207	1.204
ROA	11,082	0.132	0.133	0.167	0.081	0.192
Annual returns	11,082	0.163	0.118	0.535	-0.095	0.338
Annual return volatility	11,082	0.024	0.020	0.017	0.015	0.028

Table 3: Do Signatories of the Business Roundtable's *Statement on the Purpose of a Corporation* Have Better Compliance Records?

This table presents results from tests of whether Business Roundtable signatories have superior federal compliance records compared to non-signatory firms. In Column (1), we assess whether signatories have an overall lower likelihood of being sanctioned for violations of federal law; the dependent variable, $VIOLATION_{it}$ is an indicator that takes the value of 1 if firm *i* committed at least one violation of federal law in year *t*. We estimate a probit specification in this column. Column (2) replaces the dependent variable with the log of the total level of fines incurred by firm *i* in year *t*; the specification is linear in this setting. Columns (3)-(6) assess specific types of violations, to test whether signatory firms have superior performance relative to non-signatory firms with respect to corporate behaviors specifically called out on the *Statement*. Specifically, columns (3) and (4) re-construct the dependent variables in columns (1) and (2), respectively, based on labor violations only; Columns (5) and (6) consider only environmental violations. In columns (7) and (8) we consider the most serious instances of noncompliance; in Column (7) the dependent variable is an indicator that takes the value of 1 if firm *i* paid out a settlement in a labor lawsuit in year *t*, while in column (8) the dependent variable is an indicator for whether firm *i* was sanctioned, either via a shareholder lawsuit settlement or SEC enforcement action, for financial misconduct. All specifications include Fama-French 12 industry and year fixed effects, and standard errors are clustered by firm. *, **, and *** denote significance at 10%, 5%, and 1% levels, respectively. Standard errors are in brackets beneath coefficient estimates.

Dependent variable:	Any violation indicator	Log violation $	Labor violation indicator	Log labor violation $	Environmental violation indicator	Environmental violation $	Labor lawsuit	Financial misconduct
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
BRT Signatory	0.5260***	2.2155***	0.3967***	1.3101***	0.4829***	1.1231***	0.2995*	0.0425
	[4.06]	[3.74]	[2.97]	[3.00]	[3.35]	[2.89]	[1.90]	[0.19]
Log market value	0.3374***	1.6885***	0.2483***	0.8163***	0.2183***	0.4168**	0.3994***	0.2339**
	[6.21]	[6.91]	[4.58]	[4.89]	[3.25]	[2.44]	[6.50]	[2.22]
Market to book	-0.0251***	-0.0902***	-0.0236***	-0.0622***	-0.0081	-0.0079	-0.0220**	0.0066
	[-3.43]	[-3.22]	[-2.98]	[-2.72]	[-0.85]	[-0.42]	[-2.09]	[0.38]
Log sales growth rate	-0.6535**	-2.5246*	-0.2413	-0.9317	-0.3224	-1.0614	-1.2933**	0.0192
	[-1.97]	[-1.92]	[-0.71]	[-0.91]	[-0.56]	[-0.80]	[-2.05]	[0.04]
ROA	-2.6982***	-9.5011**	-1.6480*	-2.6128	-3.3631***	-3.8989	-0.8764	-7.6629***
	[-2.93]	[-2.44]	[-1.67]	[-0.97]	[-2.90]	[-1.45]	[-0.91]	[-3.84]
Change in ROA	-0.2927	0.8912	-0.7788	-0.7399	2.8229**	2.7037	1.9280	0.0566
	[-0.30]	[0.45]	[-0.97]	[-0.55]	[2.00]	[1.26]	[1.11]	[0.05]
Leverage	0.0947***	0.3895***	0.0818**	0.2456**	0.0282	0.0346	0.0557	0.0240
	[2.91]	[3.22]	[2.44]	[2.58]	[0.65]	[0.41]	[1.40]	[0.37]
Adjusted/Pseudo R^2	0.2280	0.3007	0.2166	0.2498	0.2279	0.2052	0.2887	0.3800
Industry fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Number of observations	1,180	1,180	1,180	1,180	1,180	1,180	1,130	970

Table 4: Compliance Records by Year

This table presents results from tests of whether Business Roundtable signatories have superior federal compliance records compared to non-signatory firms on a year-by-year basis for the five years prior to the August 2019 signing of the *Statement*. In Panel A, we assess whether signatories have an overall lower likelihood of being sanctioned for violations of federal law; the dependent variable, $VIOLATION_{it}$ is an indicator that takes the value of 1 if firm *i* committed at least one violation of federal law in year *t*. Panels B and C assess specific types of violations, to test whether signatory firms have superior performance relative to non-signatory firms with respect to corporate behaviors specifically called out on the *Statement*. Panel B re-constructs the dependent variable based on labor violations only while Panel C considers only environmental violations. Each panel contains five columns pertaining to models estimated within each of the five years. Control variables are the same as in Table 3, but for brevity we do not tabulate these. All specifications include Fama-French 12 industry fixed effects. *, **, and *** denote significance at 10%, 5%, and 1% levels, respectively. Standard errors are in brackets beneath coefficient estimates.

Panel A: All Violations

Year:	2014	2015	2016	2017	2018
	(1)	(2)	(3)	(4)	(5)
BRT Signatory	0.6770***	0.3784*	0.4535**	0.6657***	0.6401***
	[3.49]	[1.91]	[2.27]	[3.36]	[3.41]
Pseudo R^2	0.2768	0.3198	0.3256	0.2920	0.2292
Control variables	Yes	Yes	Yes	Yes	Yes
Industry fixed effects	Yes	Yes	Yes	Yes	Yes
Number of observations	236	236	236	236	236

Panel B: Labor Violations

Year:	2014	2015	2016	2017	2018
	(1)	(2)	(3)	(4)	(5)
BRT Signatory	0.3964**	0.3056	0.3389*	0.5780***	0.5507**
	[2.05]	[1.59]	[1.70]	[2.95]	[2.49]
Pseudo R^2	0.2168	0.2659	0.3091	0.2533	0.2617
Control variables	Yes	Yes	Yes	Yes	Yes
Industry fixed effects	Yes	Yes	Yes	Yes	Yes
Number of observations	222	236	236	236	208

Panel C: Environmental Violations

Year:	2014	2015	2016	2017	2018
	(1)	(2)	(3)	(4)	(5)
BRT Signatory	0.7959***	0.7603***	0.4635*	0.3257	0.2655
	[3.16]	[3.01]	[1.68]	[1.34]	[1.00]
Pseudo R^2	0.2252	0.2967	0.2665	0.2632	0.2529
Control variables	Yes	Yes	Yes	Yes	Yes
Industry fixed effects	Yes	Yes	Yes	Yes	Yes
Number of observations	206	193	166	236	186

Table 5: Do Signatories of the *Statement* Exhibit Rent-Seeking Traits?

This table presents results from regression models that assess whether Business Roundtable signatories exhibit rent-seeking traits or traits that could potentially invite external scrutiny. In Panel A, we focus on traits that may indicate managerial myopia or entrenchment as well as connectedness. Panel B focuses on financial traits that, while not evidence of rent-seeking behavior, may invite external scrutiny from regulators or investors.

Panel A: Entrenchment and Connectedness

This panel provides regression results pertaining to behaviors often perceived to reflect poorer corporate governance or managerial entrenchment. In Column (1), we assess whether signatories spend more money on lobbying relative to peer firms; the dependent variable is the log of one plus the total dollar value spent on lobbying at the firm-year level. In Column (2) we assess whether signatory firms' CEOs are more likely to have abnormally high compensation. In Column (3) we employ the Bebchuk et al. (2009) entrenchment index to assess whether management at signatory firms appears to have more power relative to shareholders (i.e., be more entrenched). In Column (4) we test whether BRT signatories have more insiders on their boards relative to non-signatory peers. Finally, in Column (5) we test whether BRT signatories' managers are more likely to issue guidance on shareholder proposals that contradicts the guidance issued by Institutional Shareholder Services (ISS). All specifications include Fama-French 12 industry and year fixed effects, and standard errors are clustered by firm. *, **, and *** denote significance at 10%, 5%, and 1% levels, respectively. Standard errors are in brackets beneath coefficient estimates.

Dependent variable:	Log lobbying dollars	Log abnormal CEO pay	Entrenchment index	% independent directors	Management/ISS disagreement on governance proposal
	(1)	(2)	(3)	(4)	(5)
BRT Signatory	2.8425***	0.4327*	0.0638	-0.0331**	0.3157*
	[3.79]	[1.81]	[0.57]	[-2.52]	[1.91]
Log market value	2.1418***	-0.0564	-0.2204***	-0.0218***	0.5668***
	[9.58]	[-0.38]	[-5.60]	[-4.37]	[9.21]
Market to book	-0.0726**	-0.0127*	-0.0023	0.0009	-0.0296***
	[-2.34]	[-1.77]	[-0.54]	[1.18]	[-2.97]
Log sales growth rate	-3.4591**	-0.6512	0.1917	-0.0428	-0.9609*
	[-2.26]	[-1.59]	[0.88]	[-1.44]	[-1.91]
ROA	-1.3844	1.7793	0.2280	-0.0282	-0.6314
	[-0.29]	[1.21]	[0.31]	[-0.31]	[-0.49]
Change in ROA	3.2183	0.2878	-0.9994*	-0.0118	-1.5639
	[1.52]	[0.21]	[-1.75]	[-0.24]	[-1.40]
Leverage	0.1560	0.0433*	0.0052	-0.0002	0.1229***
	[1.15]	[1.69]	[0.37]	[-0.06]	0.3157*
Adjusted/Pseudo R^2	0.3319	0.0368	0.1995	0.1951	0.2720
Industry fixed effects	Yes	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes	Yes
Number of observations	1,180	984	942	922	1,050

Panel B: Firm Performance

This panel provides evidence of differences between signatory firms and propensity score-matched non-signatory firms with respect to market share (which regulators may account for when allowing or disallowing mergers) as well as operating margins (which investors are likely to take into account). Columns (1)-(2) assess whether signatory firms have higher market shares than peer firms, where market shares are based on sales and calculated within 2-digit and 3-digit SIC industry. We control for industry-year differences via the corresponding 2- or 3- digit SIC industry-year fixed effects. Column (3) compares the operating margins of signatory firms against their peers. Column (4) compares alphas, computed using the Fama-French 4-factor model based on monthly returns over the past five years, of signatory firms against their peers. We measure operating margin as the ratio of EBIT to net sales. As we are pooling firms across several industries in these analyses, and the determinants of profitability vary structurally by industry, we do not incorporate further control variables. All specifications include Fama-French 12 industry and year fixed effects, and standard errors are clustered by firm. *, **, and *** denote significance at 10%, 5%, and 1% levels, respectively. Standard errors are in brackets beneath coefficient estimates.

Dependent variable:	Market share (2-digit SIC)	Market share (3-digit SIC)	Operating margin	Alpha
	(1)	(2)	(4)	(5)
BRT Signatory	0.0095*	0.0203*	-0.0613***	-0.0027***
	[1.81]	[1.87]	[-3.88]	[-3.53]
Adjusted R^2	0.6099	0.4662	0.3295	-
Industry-year fixed effects	Yes	Yes	No	No
Industry fixed effects	No	No	Yes	No
Year fixed effects	No	No	Yes	No
Number of observations	1,090	890	1,180	236

Table 6: Event Study

This table presents results from market reaction tests to the August 19, 2019 announcement of the Business Roundtable's updated *Statement on the Purpose of a Corporation*. In all cases, to estimate firm-level betas used in computing abnormal returns, we use an estimation window of 250 trading days before the event up until 30 days before. We consider three different event windows for calculating cumulative abnormal returns. Column (1) corresponds to a "short" event window of (0, +1), i.e., the announcement day and the next trading day. Column (2) corresponds to a "medium" event window of (-1, +3). Column (3) corresponds to a "long" event window of (-3, +15). *, **, and *** denote significance at 10%, 5%, and 1% levels, respectively. Standard errors are in brackets beneath coefficient estimates.

CAR event window:	(0,+1)	(-1,+3)	(-3,+15)
	(1)	(2)	(3)
BRT Signatory	0.0026	0.0022	0.0139
	[0.90]	[0.47]	[1.31]
Log market value	-0.0019	-0.0017	-0.0148***
	[-1.56]	[-1.14]	[-3.72]
Market to book	-0.0002	-0.0004	-0.0010
	[-0.78]	[-1.06]	[-1.55]
ROA	-0.0066	-0.0068	-0.0169
	[-0.39]	[-0.34]	[-0.40]
Leverage	0.0003	0.0018	0.0038
	[0.25]	[0.88]	[1.02]
Adjusted R^2	0.0194	0.0076	0.1223
Number of observations	234	234	234

Table 7: What Determines ESG Index Membership?

This table presents results from probit models of ESG index membership determination. The dependent variables in each column are indicator variables for whether firm *i* was added to the stated index (KLD 400 in Columns (1)-(4); FTSE4Good US Select Index in Columns (5)-(8)) index in year *t* + 1 while all control variables are measured in year *t*. Our main independent variable of interest is compliance violations, captured using the log of the sum of the last three years' (*t, t*-1, and *t*-2) cumulative penalties paid for federal compliance violations. We consider two separate types of specifications: one in which we consider all violations together, and one in which we impose separate thresholds for labor and environmental violations. Columns (1), (2), (5), and (6) document index inclusion as a function of compliance record and financial performance-related control variables; Columns (3), (4), (7), and (8) further consider the role of negative news. All specifications include Fama-French 12 industry and year fixed effects, and standard errors are clustered by firm. *, **, and *** denote significance at 10%, 5%, and 1% levels, respectively. Standard errors are in brackets beneath coefficient estimates.

Specification:	Compliance (KLD 400)		Compliance and negative news (KLD 400)		Compliance (FTSE4Good)		Compliance and negative news (FTSE4Good)	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Any federal violation	0.0012		0.0005		-0.0081		0.0004	
	[0.27]		[0.09]		[-1.57]		[0.06]	
Labor violations		0.0065		0.0080		-0.0182***		-0.0134*
		[1.12]		[1.23]		[-2.68]		[-1.71]
Environmental violations		-0.0202***		-0.0119*		-0.0106		-0.0031
		[-3.17]		[-1.70]		[-1.47]		[-0.39]
Negative labor news			-0.0961	-0.1050			-0.1483	-0.1418
			[-1.00]	[-1.09]			[-1.34]	[-1.28]
Negative environmental news			-0.3384***	-0.3131***			-0.3757***	-0.3482***
			[-4.40]	[-4.16]			[-4.03]	[-3.82]
Negative anticorruption news			-0.2777***	-0.2759***			-0.2951***	-0.3086***
			[-2.89]	[-2.90]			[-3.09]	[-3.32]
Negative human rights news			-0.2995***	-0.3038***			-0.2419**	-0.2250**
			[-3.78]	[-3.83]			[-2.57]	[-2.43]
KLD CSR score			0.1769***	0.1765***			0.0638***	0.0618***
			[14.44]	[14.39]			[4.47]	[4.32]
S&P 500 indicator	0.7970***	0.8148***	0.4619***	0.4670***	1.2073***	1.2109***	1.2580***	1.2684***
	[10.73]	[10.96]	[4.89]	[4.94]	[12.21]	[12.34]	[11.17]	[11.28]

Log market value	0.1716***	0.1797***	0.1886***	0.1880***	0.2121***	0.2277***	0.2681***	0.2849***
	[7.00]	[7.39]	[5.41]	[5.43]	[4.88]	[5.26]	[5.18]	[5.47]
Market to book	0.0108***	0.0104***	0.0092**	0.0093**	-0.0009	-0.0015	-0.0004	-0.0015
	[2.94]	[2.84]	[2.10]	[2.14]	[-0.28]	[-0.45]	[-0.11]	[-0.36]
ROA	-0.0320**	-0.0306**	0.2355	0.2229	0.0011	0.0032	0.3533	0.2838
	[-2.40]	[-2.32]	[0.74]	[0.70]	[0.08]	[0.22]	[1.22]	[0.99]
Leverage	0.2693	0.1946	-0.0299*	-0.0299*	0.3966	0.3107	-0.0040	-0.0001
	[1.06]	[0.78]	[-1.86]	[-1.88]	[1.53]	[1.21]	[-0.23]	[-0.01]
Annual returns	-0.0819***	-0.0830***	-0.0516*	-0.0518*	-0.1190***	-0.1243***	-0.1147**	-0.1180**
	[-3.06]	[-3.08]	[-1.91]	[-1.91]	[-2.61]	[-2.69]	[-2.27]	[-2.32]
Annual return volatility	-5.1123**	-5.0350**	-1.4049	-1.3245	-9.4618***	-9.7927***	-4.2406	-4.4638
	[-2.14]	[-2.11]	[-0.51]	[-0.49]	[-2.76]	[-2.86]	[-1.15]	[-1.21]
Pseudo R^2	0.208	0.210	0.214	0.215	0.295	0.298	0.304	0.306
Number of observations	19,650	19,650	11,653	11,653	11,082	11,082	8,021	8,021

Table 8: What Determines ESG Index Addition?

This table presents results from probit models of ESG index membership determination. The dependent variables in each column are indicator variables for whether firm *i* was added to the stated index (KLD 400 or FTSE4Good US Select Index) index in year *t* + 1 while all control variables are measured in year *t*. Our main independent variable of interest is compliance violations, captured using the log of the sum of the last three years' (*t, t*-1, and *t*-2) cumulative penalties paid for federal compliance violations. We consider two separate types of specifications: one in which we consider all violations together, and one in which we impose separate thresholds for labor and environmental violations. Panel A presents results for the KLD 400 index, while Panel B presents results for the FTSE4Good US Select index. In both panels, Columns (1) and (2) document index inclusion as a function of compliance record and financial performance-related control variables; Columns (3) and (4) include proxies for corporate governance; Columns (5) and (6) consider the role of negative news; while Columns (7) and (8) consider the role of both negative news and ESG scores assessed by MSCI (popularly known as "KLD scores"). All specifications include Fama-French 12 industry and year fixed effects, and standard errors are clustered by firm. *, **, and *** denote significance at 10%, 5%, and 1% levels, respectively. *t*-statistics are in brackets beneath coefficient estimates.

Panel A: KLD 400

The subsample in this panel is all firms with total assets over $750 million; this threshold represents a conservative lower bound on the set of firms covered by RepRisk.

Specification:	Compliance		Compliance and governance		Compliance and negative news		Compliance, negative news, and ESG scores	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Any federal violation	-0.0013		-0.0083		0.0015		0.0690	
	[-0.28]		[-1.64]		[0.32]		[0.82]	
Labor violations		0.0018		-0.0042		0.0048		0.0934
		[0.30]		[-0.64]		[0.78]		[1.05]
Environmental violations		-0.0100		-0.0089		-0.0047		-0.0660
		[-1.42]		[-1.20]		[-0.67]		[-0.46]
Log abnormal CEO pay			0.0028	-0.0005				
			[0.12]	[-0.02]				
% independent directors			-0.8628**	-0.8527**				
			[-2.54]	[-2.50]				
Negative labor news					-0.0160	-0.0196	0.0060	0.0017
					[-0.10]	[-0.12]	[0.03]	[0.01]
Negative environmental news					-0.2027**	-0.1909*	-0.3056**	-0.2942**
					[-1.97]	[-1.85]	[-2.36]	[-2.27]
Negative anticorruption news					0.0606	0.0629	0.0752	0.0812
					[0.45]	[0.47]	[0.47]	[0.51]
Negative human rights news					-0.3414**	-0.3447**	-0.3957***	-0.4010***

					[-2.46]	[-2.49]	[-2.58]	[-2.61]
CSR score (from MSCI)							0.1015***	0.1019***
							[6.79]	[6.82]
S&P 500 indicator	0.0601	0.0690	-0.1260	-0.1248	0.0881	0.0906	-0.2460**	-0.2427**
	[0.73]	[0.85]	[-1.18]	[-1.17]	[1.09]	[1.14]	[-2.15]	[-2.12]
Log market value	0.1718***	0.1748***	0.1761***	0.1738***	0.2090***	0.2098***	0.2276***	0.2287***
	[7.51]	[7.73]	[5.25]	[5.22]	[8.44]	[8.47]	[6.05]	[6.08]
Market to book	0.0019	0.0018	0.0036	0.0039	0.0012	0.0011	0.0041	0.0039
	[0.39]	[0.37]	[0.62]	[0.68]	[0.24]	[0.23]	[0.66]	[0.64]
ROA	0.0060	0.0063	-0.0045	-0.0057	0.0078	0.0079	0.3917	0.3977
	[0.38]	[0.41]	[-0.22]	[-0.28]	[0.51]	[0.51]	[1.03]	[1.05]
Leverage	0.4489	0.4161	0.5555*	0.5322	0.3352	0.3301	0.0065	0.0071
	[1.53]	[1.43]	[1.70]	[1.64]	[1.15]	[1.13]	[0.31]	[0.34]
Annual returns	0.0488	0.0483	0.0542	0.0550	0.0388	0.0384	0.0473	0.0471
	[1.39]	[1.37]	[1.18]	[1.17]	[1.01]	[1.00]	[1.41]	[1.40]
Annual return volatility	0.0601	0.0690	-0.1260	-0.1248	0.0881	0.0906	-0.8160	-0.7198
	[0.73]	[0.85]	[-1.18]	[-1.17]	[1.09]	[1.14]	[-0.24]	[-0.21]
Pseudo R^2	0.099	0.100	0.073	0.073	0.108	0.108	0.115	0.116
Number of observations	16,230	16,230	9,179	9,179	16,230	16,230	9,067	9,067

Panel B: FTSE4Good US Select Index

The subsample in this panel is all firms ever in the Russell 1000; this represents a conservative estimate of the set of firms from which FTSE Russell chooses firms to include in its FTSE4Good US Select index.

Specification:	Compliance		Compliance and governance		Compliance and negative news		Compliance, negative news, and ESG scores	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Any federal violation	-0.0066		-0.0040		-0.0034		0.0037	
	[-1.04]		[-0.58]		[-0.53]		[0.03]	
Labor violations		-0.0144*		-0.0071		-0.0122		-0.0554
		[-1.79]		[-0.83]		[-1.54]		[-0.50]
Environmental violations		-0.0056		-0.0097		-0.0035		0.0362
		[-0.67]		[-1.16]		[-0.42]		[0.25]
Log abnormal CEO pay			-0.0352	-0.0357				
			[-1.56]	[-1.50]				
% independent directors			-1.4237***	-1.3780***				
			[-3.46]	[-3.35]				
Negative labor news					-0.1269	-0.1230	-0.1026	-0.1049
					[-0.76]	[-0.73]	[-0.55]	[-0.57]
Negative environmental news					-0.0945	-0.0762	-0.0669	-0.0649
					[-0.80]	[-0.62]	[-0.47]	[-0.45]
Negative anticorruption news					-0.3157**	-0.3266**	-0.3207*	-0.3232*
					[-2.19]	[-2.29]	[-1.91]	[-1.92]
Negative human rights news					-0.1286	-0.1137	-0.1341	-0.1284
					[-0.96]	[-0.85]	[-0.86]	[-0.82]
CSR score (from MSCI)							0.0218	0.0214
							[1.36]	[1.33]
S&P 500 indicator	0.5211***	0.5238***	0.5223***	0.5231***	0.4975***	0.5037***	0.4956***	0.4993***
	[4.58]	[4.67]	[4.00]	[4.04]	[4.42]	[4.55]	[3.43]	[3.46]
Log market value	0.2029***	0.2156***	0.1249***	0.1397***	0.2722***	0.2817***	0.2575***	0.2608***

	[4.96]	[5.22]	[2.77]	[3.06]	[6.09]	[6.32]	[4.55]	[4.58]
Market to book	0.0056	0.0051	0.0073	0.0068	0.0043	0.0038	0.0073	0.0070
	[1.24]	[1.16]	[1.22]	[1.16]	[0.96]	[0.86]	[1.54]	[1.50]
ROA	-0.0279*	-0.0265	-0.0439**	-0.0419**	-0.0249	-0.0233	0.1748	0.1578
	[-1.68]	[-1.62]	[-2.12]	[-2.05]	[-1.47]	[-1.39]	[0.57]	[0.52]
Leverage	0.3260	0.2658	0.1639	0.0981	0.2197	0.1719	-0.0452**	-0.0444**
	[1.30]	[1.08]	[0.44]	[0.26]	[0.89]	[0.71]	[-2.34]	[-2.31]
Annual returns	0.0182	0.0160	0.1164	0.1141	-0.0028	-0.0042	0.0386	0.0386
	[0.21]	[0.18]	[1.55]	[1.50]	[-0.03]	[-0.04]	[0.47]	[0.47]
Annual return volatility	0.3533	0.2629	-1.3370	-1.2652	0.8444	0.7593	5.0091	4.9796
	[0.24]	[0.16]	[-0.29]	[-0.27]	[0.80]	[0.65]	[1.54]	[1.53]
Pseudo R^2	0.143	0.145	0.154	0.156	0.151	0.153	0.159	0.159
Number of observations	7,819	7,819	5,970	5,970	7,819	7,819	5,449	5,449

Table 9: What Determines ESG Index Deletion?

This table presents results from probit models of ESG index membership deletion. The dependent variables in each column are indicator variables for whether firm *i* was deleted from the stated index (KLD 400 or FTSE4Good US Select Index) index in year *t* +1 while all control variables are measured in year *t*. Our main independent variable of interest is compliance violations, captured using the log of the sum of the last three years' (*t, t*-1, and *t*-2) cumulative penalties paid for federal compliance violations. We consider two separate types of specifications: one in which we consider all violations together, and one in which we impose separate thresholds for labor and environmental violations. Panel A presents results for the KLD 400 index, while Panel B presents results for the FTSE4Good US Select index. In both panels, Columns (1) and (2) document index deletion as a function of compliance record and financial performance-related control variables; Columns (3) and (4) include proxies for corporate governance; Columns (5) and (6) consider the role of negative news; while Columns (7) and (8) consider the role of both negative news and ESG scores assessed by MSCI (popularly known as "KLD scores"). All specifications include Fama-French 12 industry and year fixed effects, and standard errors are clustered by firm. *, **, and *** denote significance at 10%, 5%, and 1% levels, respectively. *t*-statistics are in brackets beneath coefficient estimates.

Panel A: KLD 400

The subsample in this panel is all firms in the KLD400 in year *t.*

Specification:	Compliance		Compliance and governance		Compliance and negative news		Compliance, negative news, and ESG scores	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Any federal violation	-0.0006		0.0022		0.0003		-0.0045	
	[-0.08]		[0.30]		[0.04]		[-0.57]	
Labor violations		-0.0057		-0.0004		-0.0047		-0.0013
		[-0.68]		[-0.04]		[-0.56]		[-0.13]
Environmental violations		0.0049		0.0026		0.0055		-0.0070
		[0.52]		[0.26]		[0.58]		[-0.64]
Log abnormal CEO pay			-0.0313	-0.0306				
			[-0.84]	[-0.82]				
% independent directors			-0.1363	-0.1325				
			[-0.30]	[-0.29]				
Negative labor news					-0.1822	-0.1740	-0.1580	-0.1635
					[-0.90]	[-0.86]	[-0.71]	[-0.74]
Negative environmental news					-0.0344	-0.0401	0.0120	0.0225
					[-0.27]	[-0.31]	[0.08]	[0.15]
Negative anticorruption news					0.1142	0.1175	0.2706	0.2610
					[0.76]	[0.78]	[1.49]	[1.44]
Negative human rights news					-0.1610	-0.1600	0.0543	0.0539

					[-0.93]	[-0.93]	[0.27]	[0.27]
CSR score (from MSCI)							-0.0936***	-0.0938***
							[-4.97]	[-5.00]
S&P 500 indicator	-0.0453	-0.0466	-0.0851	-0.0863	-0.0598	-0.0607	-0.0591	-0.0580
	[-0.40]	[-0.41]	[-0.66]	[-0.67]	[-0.53]	[-0.54]	[-0.44]	[-0.43]
Log market value	-0.0685	-0.0671	-0.0560	-0.0530	-0.0449	-0.0438	0.0503	0.0480
	[-1.25]	[-1.23]	[-0.99]	[-0.95]	[-0.77]	[-0.75]	[0.72]	[0.69]
Market to book	-0.0076	-0.0079	-0.0044	-0.0048	-0.0082	-0.0085	-0.0036	-0.0033
	[-1.11]	[-1.15]	[-0.58]	[-0.63]	[-1.19]	[-1.24]	[-0.42]	[-0.39]
ROA	0.0367	0.0373	0.0287	0.0296	0.0380	0.0387	0.0476	0.0473
	[1.53]	[1.57]	[1.13]	[1.17]	[1.60]	[1.63]	[1.62]	[1.60]
Leverage	-0.1980	-0.2091	-0.3914	-0.4063	-0.2510	-0.2589	-0.4633	-0.4544
	[-0.41]	[-0.44]	[-0.76]	[-0.79]	[-0.52]	[-0.54]	[-0.84]	[-0.82]
Annual returns	0.0109	0.0093	0.0566	0.0544	0.0019	0.0004	-0.2785*	-0.2749*
	[0.11]	[0.09]	[0.58]	[0.56]	[0.02]	[0.00]	[-1.70]	[-1.68]
Annual return volatility	6.1227	5.9351	8.8926*	8.8980*	6.3791	6.2254	8.0495	8.0284
	[1.24]	[1.20]	[1.70]	[1.70]	[1.30]	[1.27]	[1.43]	[1.43]
Pseudo R^2	0.098	0.098	0.087	0.087	0.100	0.101	0.116	0.116
Number of observations	3,420	3,420	2,879	2,879	3,420	3,420	2,614	2,614

Panel B: FTSE4Good US Select Index
The subsample in this panel is all firms in the FTSE4Good US Select Index in year *t*.

Specification:	Compliance		Compliance and governance		Compliance and negative news		Compliance, negative news, and ESG scores	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Any federal violation	0.0045		0.0074		0.0014		-0.0122	
	[0.70]		[1.08]		[0.22]		[-1.44]	
Labor violations		0.0043		0.0060		0.0039		0.0076
		[0.50]		[0.65]		[0.44]		[0.70]
Environmental violations		0.0044		0.0063		0.0030		-0.0043
		[0.46]		[0.64]		[0.32]		[-0.34]
Log abnormal CEO pay			-0.0394	-0.0358				
			[-1.09]	[-0.99]				
% independent directors			-0.2599	-0.2665				
			[-0.46]	[-0.47]				
Negative labor news					0.2027	0.1995	0.4086*	0.3643
					[1.12]	[1.09]	[1.69]	[1.52]
Negative environmental news					0.2645**	0.2565*	0.3915**	0.3920**
					[1.98]	[1.87]	[2.24]	[2.21]
Negative anticorruption news					0.3241**	0.3346**	0.1224	0.1355
					[2.34]	[2.42]	[0.58]	[0.65]
Negative human rights news					-0.1794	-0.1788	-0.1139	-0.1056
					[-1.07]	[-1.06]	[-0.46]	[-0.43]
CSR score (from MSCI)							-0.0587***	-0.0574***
							[-2.89]	[-2.91]
S&P 500 indicator	-0.0513	-0.0485	0.0206	0.0239	-0.0332	-0.0347	-0.0239	-0.0363
	[-0.50]	[-0.47]	[0.17]	[0.20]	[-0.32]	[-0.34]	[-0.20]	[-0.30]
Log market value	-0.3151***	-0.3141***	-0.3047***	-0.3015***	-0.3829***	-0.3857***	-0.3994***	-0.4206***
	[-5.08]	[-5.25]	[-4.84]	[-4.98]	[-5.67]	[-5.81]	[-4.24]	[-4.54]

Market to book	-0.0086	-0.0086	-0.0117*	-0.0121*	-0.0065	-0.0064	-0.0175**	-0.0161**
	[-1.47]	[-1.48]	[-1.87]	[-1.95]	[-1.10]	[-1.07]	[-2.48]	[-2.30]
ROA	0.0455**	0.0459**	0.0550**	0.0565**	0.0391*	0.0386*	0.0645**	0.0610**
	[2.11]	[2.12]	[2.31]	[2.37]	[1.80]	[1.78]	[2.45]	[2.43]
Leverage	-0.5061	-0.4927	-0.3494	-0.3370	-0.3248	-0.2995	-0.2407	-0.1537
	[-1.02]	[-0.99]	[-0.69]	[-0.66]	[-0.64]	[-0.59]	[-0.42]	[-0.26]
Annual returns	-0.1043	-0.1058	-0.0950	-0.0990	-0.0644	-0.0629	-0.1388	-0.1312
	[-0.81]	[-0.82]	[-0.68]	[-0.70]	[-0.50]	[-0.49]	[-0.90]	[-0.86]
Annual return volatility	9.4192**	9.5236**	8.4024*	8.5531*	8.8621*	8.9376**	13.6022***	13.5456***
	[2.10]	[2.13]	[1.81]	[1.84]	[1.96]	[1.98]	[2.64]	[2.64]
Pseudo R^2	0.485	0.485	0.481	0.481	0.491	0.491	0.198	0.197
Number of observations	3,299	3,299	3,097	3,097	3,299	3,299	2,593	2,593

Table 10: ESG Index Addition and Compliance Records

This table estimates difference-in-differences models of compliance violations as a function of firms' inclusion into either the KLD 400 or FTSE4Good US Select indices. In all columns the primary independent variables are indicators for the number of years subsequent to ESG index addition; for example, if a firm was added to either ESG index in 2013, then in 2015 the "2 years post ESG index addition" indicator equals 1 for that firm while all other ESG index addition indicators equal zero. For brevity we do not tabulate indicators for more than 5 years subsequent to ESG index addition. In Column (1), we assess whether firms added to an ESG index subsequently have an overall lower likelihood of being sanctioned for violations of federal law; the dependent variable, $VIOLATION_{it}$, is an indicator that takes the value of 1 if firm *i* committed at least one violation of federal law in year *t*. Column (2) replaces the dependent variable with the log of the total level of fines incurred by firm *i* in year *t*. Columns (3)-(6) assess specific types of violations, to test whether the effects of index addition, if any, are concentrated amongst specific types of violations. Specifically, Columns (3) and (4) re-construct the dependent variables in Columns (1) and (2), respectively, based on labor violations only; Columns (5) and (6) consider only environmental violations. All specifications include firm and year fixed effects, and standard errors are clustered by firm. *, **, and *** denote significance at 10%, 5%, and 1% levels, respectively. *t*-statistics are in brackets beneath coefficient estimates.

Dependent variable:	Any violation indicator	Log any violation $	Labor violation indicator	Log labor violation $	Environmental violation indicator	Log environmental violation $
	(1)	(2)	(3)	(4)	(5)	(6)
Year of ESG index addition	0.0023	-0.1230	0.0255	0.3611*	0.0129	0.0936
	[0.10]	[-0.47]	[1.25]	[1.71]	[0.84]	[0.53]
1 year post ESG index addition	-0.0068	-0.2121	0.0072	0.1337	0.0093	0.0437
	[-0.26]	[-0.68]	[0.30]	[0.55]	[0.55]	[0.23]
2 years post ESG index addition	-0.0200	-0.2635	0.0085	0.2420	0.0016	-0.0265
	[-0.69]	[-0.76]	[0.30]	[0.84]	[0.09]	[-0.13]
3 years post ESG index addition	0.0680**	0.7771*	0.0558*	0.6961**	0.0288	0.2742
	[2.13]	[1.94]	[1.95]	[2.36]	[1.30]	[1.09]
4 years post ESG index addition	-0.0114	-0.1042	0.0263	0.4295	-0.0137	-0.1479
	[-0.33]	[-0.25]	[0.79]	[1.26]	[-0.65]	[-0.60]
5 years post ESG index addition	0.0023	-0.1230	0.0255	0.3611*	0.0129	0.0936
	[0.10]	[-0.47]	[1.25]	[1.71]	[0.84]	[0.53]
Log market value	0.0188*	0.3106**	0.0148	0.2011*	0.0010	0.0238
	[1.66]	[2.06]	[1.39]	[1.79]	[0.15]	[0.33]
Market to book	-0.0035***	-0.0482***	-0.0026**	-0.0290**	-0.0001	-0.0006
	[-3.27]	[-3.58]	[-2.42]	[-2.45]	[-0.15]	[-0.15]
Log sales growth rate	0.0141	0.0034	0.0466	0.4500	0.0115	0.1710
	[0.39]	[0.01]	[1.34]	[1.30]	[0.36]	[0.43]

ROA	-0.0320	-0.5360	-0.0754	-0.6609	-0.0064	-0.2309
	[-0.37]	[-0.50]	[-0.90]	[-0.75]	[-0.14]	[-0.42]
Change in ROA	-0.0127	-0.2185	-0.0253	-0.2956	-0.0026	-0.0657
	[-0.80]	[-0.95]	[-1.40]	[-1.48]	[-0.30]	[-0.60]
Leverage	0.0132***	0.1969***	0.0073*	0.0777**	0.0006	0.0051
	[3.39]	[3.77]	[1.90]	[2.05]	[0.40]	[0.35]
Adjusted R^2	0.4664	0.4704	0.4395	0.4704	0.3707	0.3988
Firm fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Number of observations	8,326	8,326	8,326	8,326	8,326	8,326

Table 11: Does ESG Index Addition Influence Rent-Seeking Behavior?

This table provides results from a staggered difference-in-differences specification that test whether ESG index addition influences corporate behaviors often perceived to reflect poorer corporate governance or managerial entrenchment. In all columns the primary independent variables are indicators for the number of years subsequent to ESG index addition; for example, if a firm was added to either ESG index in 2013, then in 2015 the "2 years post ESG index addition" indicator equals 1 for that firm while all other ESG index addition indicators equal zero. For brevity we do not tabulate indicators for more than 5 years subsequent to ESG index addition. In Column (1), we assess whether, subsequent to ESG index addition, firms spend more money on lobbying relative to peer firms; the dependent variable is the log of one plus the total dollar value spent on lobbying at the firm-year level. In Column (2) we assess whether ESG index addition influences portfolio firm CEOs' abnormal compensation. In Column (3) we employ the Bebchuk et al. (2009) entrenchment index to assess whether the level of entrenchment at ESG index portfolio firms changes subsequent to index inclusion. Finally, in Column (4) we test whether ESG index inclusion influences corporate governance via the percentage of insiders on portfolio firms' boards. All specifications include firm and year fixed effects (which serve as the main treatment and time indicators in our difference-in-differences specification), and standard errors are clustered by firm. *, **, and *** denote significance at 10%, 5%, and 1% levels, respectively. *t*-statistics are in brackets beneath coefficient estimates.

Dependent variable:	Log lobbying dollars	Log abnormal CEO pay	Entrenchment index	% independent directors
	(1)	(2)	(3)	(4)
Year of ESG index addition	0.0367	0.0771	-0.0356	-0.0073
	[0.17]	[1.20]	[-0.51]	[-1.10]
1 year post ESG index addition	0.1610	0.1354*	0.0651	-0.0144*
	[0.56]	[1.76]	[0.79]	[-1.80]
2 years post ESG index addition	-0.0322	0.0658	0.0616	-0.0224**
	[-0.09]	[0.66]	[0.65]	[-2.44]
3 years post ESG index addition	-0.4117	0.1214	0.1193	-0.0163
	[-1.07]	[0.90]	[1.09]	[-1.54]
4 years post ESG index addition	-0.4124	0.0239	0.1459	-0.0132
	[-0.96]	[0.22]	[1.28]	[-1.08]
5 years post ESG index addition	-0.3146	-0.0356	0.0468	-0.0077
	[-0.64]	[-0.30]	[0.36]	[-0.58]
Log market value	0.7462***	-0.1068**	0.0145	-0.0207***
	[4.06]	[-2.52]	[0.36]	[-4.30]
Market to book	-0.0424***	-0.0038*	-0.0005	0.0006
	[-3.92]	[-1.67]	[-0.36]	[1.57]
Log sales growth rate	-0.0541	-0.0087	-0.0545	0.0257***
	[-0.13]	[-0.10]	[-0.88]	[3.38]
ROA	-0.1090	-0.0577	0.8132**	0.0712**
	[-0.09]	[-0.13]	[2.46]	[2.29]
Change in ROA	-0.0274	0.0684	-0.3922**	-0.0210
	[-0.15]	[0.30]	[-2.35]	[-1.31]
Leverage	0.0963**	0.0121	0.0012	-0.0015
	[2.49]	[1.62]	[0.19]	[-1.58]
Adjusted R^2	0.7949	0.5455	0.7545	0.6647
Firm fixed effects	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes
Number of observations	8,326	6,423	4,130	7,173

Table 12: CSR Scores and Compliance Records

This table presents results from testing whether compliance violations predict CSR scores (obtained from MSCI) and the likelihood of facing negative news coverage. The dependent variables in all cases is firms' normalized CSR scores in year $t + 1$ while all control variables are measured in year t. We normalize CSR scores within-year, i.e., the "normalized CSR score" is demeaned against a yearly average taken over all firms; this is to remove the effect of MSCI changing its CSR ratings methodology in 2013. Our main independent variable of interest is compliance violations, captured using the log of the sum of the last three years' (t, t-1, and t-2) cumulative penalties paid for federal compliance violations. For CSR score-related tests, we consider two separate types of specifications: one in which we consider all violations together (in Columns (1) and (3)), and one in which we impose separate thresholds for labor and environmental violations (in Columns (2) and (4). In Columns (3) and (4) we also include as a control variable the firm's prior-year CSR score. All specifications include firm and year fixed effects. Standard errors are clustered by firm. *, **, and *** denote significance at 10%, 5%, and 1% levels, respectively. t-statistics are in brackets beneath coefficient estimates.

Dependent variable:	Normalized CSR score (1)	Normalized CSR score (2)	Normalized CSR score (3)	Normalized CSR score (4)
Any federal violation	-0.0044		-0.0037	
	[-0.68]		[-0.75]	
Labor violations		0.0107		0.0044
		[1.26]		[0.68]
Environmental violations		-0.0067		0.0013
		[-0.71]		[0.17]
Negative labor news	-0.0801	-0.0832	-0.0158	-0.0175
	[-0.54]	[-0.56]	[-0.12]	[-0.13]
Negative environmental news	0.0180	0.0195	0.0092	0.0060
	[0.18]	[0.20]	[0.10]	[0.07]
Negative anticorruption news	-0.1470	-0.1450	-0.2345*	-0.2342*
	[-1.01]	[-1.00]	[-1.82]	[-1.82]
Negative human rights news	-0.1907	-0.1910	-0.1582	-0.1571
	[-1.57]	[-1.58]	[-1.48]	[-1.47]
Lagged normalized CSR score			0.3943***	0.3942***
			[29.19]	[29.20]
Adjusted R^2	0.6345	0.6346	0.6894	0.6894
Number of observations	10,577	10,577	9,800	9,800