Responsive CSR as Damage Control and
The Effect of Institutional Owner Commitment

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This version: January 2025

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ABSTRACT

We examine the use of CSR as damage control (Responsive CSR) after a reputational shock from a securities class action (SCA) lawsuit. We find that CSR scores increase following an SCA lawsuit, and we demonstrate that it is the high reputation firms who raise their CSR scores after the crisis, consistent with reputation repair. We demonstrate the effect is weaker in business-friendly states where the lawsuit is less likely to prevail, and we also demonstrate the effect is weaker when investors have limited ability to influence management. Finally, we demonstrate that it is the firms with long-horizon institutional owners holding considerable stakes in the firm who increase their CSR scores after a SCA lawsuit.

1   Introduction

Gillan, Koch, and Starks (2021), in their extensive review of the Environmental, Social, and Governance (ESG) and Corporate Social Responsibility (CSR) literature, identify the main areas of research in EGS/CSR from a corporate finance perspective: the markets in which the firm operates, the leadership characteristics of the firm, the characteristics of the firm's owners, and the effects of ESG/CSR scores on firm risk, performance, and value. Concerning the characteristics of the firm's owners, Gillan et al. (2021) state, "the results and conclusions on institutional ownership are mixed, which calls for further examination of the preferences and influences of these investors with regard to the ESG/CSR activities of their holdings" (p. 7). This paper attempts to answer that call by examining the CSR activities of firms after a crisis event: a securities class action (SCA) lawsuit.

Institutional ownership in equities has grown significantly in recent decades, from 10% to over 60% of U.S. equities between 1953 and 2005 (Gillan and Starks (2015)), with institutions holding over 78% of the broad-based Russell 3000 index by 2017.[1] This has greatly increased the power of institutional shareholder activism and the ability of institutions to mitigate risk in their firm holdings. Prior studies suggest institutional owners (IOs) favor CSR to reduce reputational risk, especially long-term institutions (e.g., Fu, Tang, and Yan (2019); Gloßner (2019); Gillan et al. (2021); Godfrey, Merrill, and Hansen (2009)). These studies find that CSR is used proactively before a crisis as a form of "reputation insurance."

However, CSR may also be used to reduce reputational damage after a crisis event, what the accounting literature terms "Reputation Repair CSR," or what the marketing literature terms, "Reactive CSR." The public relations term is "damage control," and CSR may be used ex-post to

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[1] "80% of equity market cap held by institutions," *Pensions and Investments*, April 25, 2017.

the crisis to reduce penalties from stakeholders (Kotchen and Moon (2012); Krüger (2015); Prakash, Ravi, and Zhao (2017)). Despite the numerous studies examining IO effects on (ex-ante) "Reputation Insurance CSR," there have been no studies examining IO effects on (ex-post) "Reputation Repair CSR," which we call "Responsive CSR" following Prakash et al. (2017).

We use securities class action litigation (SCA) filings as a proxy for firm reputation shocks. These lawsuits provide an ideal proxy for a serious reputational shock because: 1) they are often filed within weeks of a triggering event, 2) they are the most damaging type of litigation for firm reputation (Haslem, Hutton, and Smith (2017)), and 3) they are usually only filed after a large decline in stock price, indicating significant firm damage.[2]

We first examine the change in the CSR score of the firm in the year of and year after the SCA lawsuit. We find that these firms experience a 4.9% increase in CSR strengths measured either in the current year or the year after the SCA filing. We next ask whether the effect is consistent with reputation repair, or damage control, by separating our sample into firms with and without previous accounting irregularities in their financial reporting following Amiram, Bozanic, and Rouen (2015) and Hoitash, Hoitash, and Johnstone (2012). We find that the firms with the highest reputations engage the most in Responsive CSR after a SCA lawsuit.

We then investigate legal and corporate settings in which we believe the effect should be stronger. First, firms are not likely to use Responsive CSR if the probability is low that lawsuits filed against them will move forward to trial and result in a loss. We filter our results using three conditions for "business-friendly" legal environments. First, we exclude firms headquartered in Universal Demand (UD) law states (Davis (2008). Second, we exclude firms headquartered in the Ninth Federal District, which places a higher burden on plaintiffs to advance an SCA case to the

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[2] In addition, our sample period occurs after the passage of the Private Securities Litigation Reform Act (PSLRA) of 1995, which reduced the filing of frivolous SCA lawsuits and thus helps clarify our findings.

discovery stage (Crane and Koch (2016)). Third, we exclude firms headquartered in the top ten most business-friendly states in terms of their legal environment as determined by the U.S. Chamber of Commerce. We predict and confirm that our results are stronger after making these exclusions. Firms invest more in Responsive CSR after an SCA lawsuit filing if they are located in legal states/districts where they are more likely to lose in court.

We also address corporate settings in which we believe the effect will be enhanced. Entrenchment devices greatly reduce the ability of shareholders to influence management. Therefore, we exclude dual class firms and firms with a classified board structure from our sample and rerun our regressions. We find the effect is strongest when these entrenchment devises are not present, such that the shareholders can influence firm management through activism. Second, we exclude SCA filings in which individual investors are the lead plaintiffs and IOs do not attempt to become the lead plaintiff in the case. Our results remain robust.

After documenting that the effect of SCA lawsuits on CSR scores appears consistent with reputation repair, and that it appears strongest in settings where we believe the effect should be enhanced, we next turn our attention to the effect of institutional owners on CSR. Specifically, we investigate the effect of the "level of commitment" of institutional owners after the triggering event, the SCA lawsuit filing. The presence of institutional owners with long-term horizons, measured either by the Bushee (1998, 2001) classifications or by the flow robust churn measure of Yan and Zhang (2009), provoke the greatest increase in CSR scores after a SCA lawsuit.[3] As well, the size of the institutional owner investment, the presence of blockholders, and the presence of multiple firm relationships all indicate that investor commitment is important as to whether the firm increases its CSR score after an SCA lawsuit.

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[3] The top quartile of SCA firms by investor horizon using the Bushee classification measures experience an 8½% increase in CSR strengths, while the top tercile of SCA firms by investor horizon using the churn measures experiences a 7½% increase in CSR strengths.

There are several endogenous relationships we address. One issue is reverse causality. The use of Insurance CSR may lead a firm to decide it does not need to guard against improper behavior and does not need Responsive CSR, especially if the firm conducts business in an industry or region historically facing heightened litigation risk. In addition, issues of joint determination are a problem since SCA filings can lead to significant financial costs that can reduce the ability of firms to utilize responsive CSR to offset reputational damage. We address these endogenous relationships in four ways. First, we control for one-year lagged CSR and two-year lagged CSR before the SCA filing year to adjust for the effects of Insurance CSR. Second, we include industry fixed effects in all models (in addition to year fixed effects). Third, we create a propensity score matched (PSM) sample that combines our lawsuit firms with a similar cohort of firms not facing SCA litigation. Fourth, we build two instrumental variables (IVs) for litigation risk. The first IV uses an index of the ease of filing of securities litigation at the federal district court level, while the second IV uses a measure of the lawsuit experience in each federal district. Our results hold throughout all these endogeneity tests.

We contribute to the literature in several ways. First, we document that firms increase their CSR scores after the filing of a securities class action lawsuit against the firm. We document that the effect is consistent with reputation repair, or damage control, after the lawsuit filing, and we show that the effect is strongest in settings where the legal environment is friendlier to the plaintiff and where the corporate setting is conducive to investor activism. This adds to the evidence in Dyck, Lins, Roth, and Wagner (2019) and Fu et al. (2019), who examine industry peer reactions to the reputation loss of a competitor. In our study, we are examining how the firm reacts with CSR after its own reputation loss (from an SCA lawsuit filing). In addition, those studies focus primarily on the oil and gas industry, whereas our study examines all but the regulated industries (financials and utilities).

Second, we add to the debate outlined in Gillan et al. (2021) and corroborate previous studies identifying a positive relationship between CSR scores and institutional ownership.[4] Moreover, we document that the relationship is indeed nuanced, as Gillan et al. (2021) suggest. The effect of institutional owners occurs only from the most committed IOs, those investors with long-term investment horizons and large stakes in the company. This evidence is similar to studies that document a positive relationship between IO investment horizon and the firm's ex-ante use of CSR as insurance to mitigate future damage.[5] However, we are examining the firm's use of ex-post CSR as damage control after the filing of a securities class action lawsuit.

The remainder of the paper is organized as follows. Section 2 discusses related literature and develops our hypotheses. Section 3 describes our sample and presents summary statistics. Section 4 presents baseline results and identification strategies. Section 5 examines whether the effect is consistent with damage control. Section 6 examines legal and corporate settings that may enhance the effect. Section 7 investigates institutional owner characteristics, and Section 8 concludes the paper.

2 Literature Review and Hypothesis Development

We start by acknowledging that there are many streams of literature regarding ESG/CSR, which is well documented in Gillan et al. (2021). We do not focus here on the literature relating to firm risk, performance, or value, nor do we focus on market characteristics or firm leadership. The focus here is on CSR use as ex-post reputation repair, but we also discuss the literature on CSR

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[4] We acknowledge the debate in Gillan et al. (2021) as to whether CSR should be the independent or dependent variable in these analyses.

[5] See Fu et al. (2019); Gloßner (2019); Kim, Kim, Kim, and Park (2019); Chen, Dong, and Lin (2020); and Shackleton, Yao, and Zuo (2025).

use as ex-ante reputation insurance. Finally, we discuss the literature relating to the characteristics of the firm's institutional owners and the firm's use of CSR after a crisis.

2.1   CSR as Reputation Insurance

An extensive literature has documented the use of CSR to provide reputational insurance to firms (Godfrey et al. (2009)). Gillan et al. (2021) highlight a nascent literature stream that identifies a subgroup of Insurance CSR that focuses on the importance of institutional owner horizon. Specifically, these studies find a positive association between firms primarily held by long-term IOs and the use of CSR as a form of insurance. For example, Gloßner (2019) finds that long investor horizons are positively associated with greater CSR usage, but blockholders are able to attenuate the use of CSR and ensure it is used efficiently and strategically. Kim et al. (2019) find a similar relationship between long-term investors and CSR, and they note that these investors have greater incentives to monitor their firms. Other recent papers (Fu et al. (2019); Nguyen, Kecskés, and Mansi (2020); Shackleton et al. (2025)) have drawn similar conclusions.

While many recent papers examining IO and ex-ante Insurance CSR find a positive relationship, Gillan et al. (2021) note that the results are mixed regarding causality and that the relationship is likely dynamic. By focusing on the relationship between IO and ex-post Responsive CSR, our study attempts to contribute to the ongoing debate regarding this relationship.

2.2   CSR as Reputation Repair

Despite the extensive literature covering Insurance CSR, the ex-post Responsive CSR research is scattered across a wide variety of business fields. In the marketing literature, both Ricks (2005) and Wagner, Lutz, and Weitz (2009) term this ex-post strategic CSR as "Reactive CSR," while in the economics literature Kotchen and Moon (2012) label it as "Offsetting CSR." In the accounting literature, Chakravarthy, deHaan, and Rajgopal (2014) find that firms undertake

community building actions after an accounting restatement in what they term "Reputation Repair." Krüger (2015), Prakash et al. (2017), and Bae, Choi, and Lim (2020), the finance studies in this area, classify this type of CSR as "Offsetting CSR," "Responsive CSR," and "Post-crisis CSR," respectively. We adopt the term Responsive CSR from Prakash et al. (2017) and Liang and Renneboog (2017), as it implies a strategic firm effort. The lack of cohesion among these literature streams is particularly surprising, since ex-post CSR (Responsive CSR) is three times as common as ex-ante CSR used as pro-active insurance (Prakash et al. (2017)) and may have historical foundations dating back to a country's legal origin (Liang and Renneboog (2017)).

Our first research question in our unique setting is whether firms engage in ex-post Responsive CSR after a securities class action lawsuit has been filed against the firm. Following the evidence on CSR use cited above, we expect a positive relation between an SCA lawsuit filing and the firm's CSR score after the event. We then ask if the effect is consistent with reputation repair by examining the CSR scores of low-reputation firms versus high-reputation firms after the SCA filing. Following the work of Amiram et al. (2015) and Hoitash et al. (2012), we expect a positive relation between reputation and CSR scores after an SCA filing. We then examine some moderating settings to corroborate that our effect seems consistent with reputation repair after a SCA filing by examining both legal and corporate settings for the firm that may influence the firm's decision-making.

Finally, we examine whether the commitment of investors is important as to whether the firm increases its CSR score after a SCA lawsuit, and we look at institutional owner horizon and IO investment size. Although no studies have examined the relationship between investor commitment and Responsive CSR, the studies focusing on Insurance CSR have suggested a positive relationship (e.g., Dyck et al. (2019); Fu et al. (2019)). We discuss this in more detail in the next section.

2.3   Responsive CSR and Institutional Owner Commitment

While numerous prior studies have found that long-term institutional owners are positively associated with CSR usage as ex-ante reputational insurance, it is unclear whether firms held by long-term IOs would initiate responsive CSR after a crisis. On one hand, it is possible that long-term institutions do not add Responsive CSR because they already have elevated levels of Insurance CSR and thus have no need for Responsive CSR ex-post. They may even reduce CSR, as the CSR insurance did not prevent the crisis event. Starks, Venkat, and Zhu (2017) note that IOs prefer to sell their holdings after a negative event. However, they also find that long-term IOs are more patient with their firm holdings after short-term negative performance, suggesting a willingness to "stay the course."

On the other hand, recent studies suggest peer firms closely related to a firm undergoing a reputational crisis increase their Insurance CSR after the crisis at the peer firm. Therefore, it seems reasonable to expect the crisis firm would also increase its CSR ex-post (as proof of their prior goodwill and commitment to CSR) in the aftermath of the crisis. For example, Dyck et al. (2019) suggest peer firms are more reactive in the years after an environmental crisis in their industry and improve their environmental and social policies. However, they do not test for differences in institutions based on horizon heterogeneity. Fu et al. (2019) find that oil and gas firms predominantly held by long-term investors increased CSR activities after the BP Deep Horizon accident.

We argue the same could be true for the firm that commits the violation; in our study we argue that firms facing SCA lawsuits would initiate Responsive CSR in a similar manner to BP after the Horizon accident. Nofsinger, Sulaeman, and Varma (2019) find that long-term IOs are indifferent to positive ESG scores, but they are particularly concerned about negative scores. This suggests they might want to mitigate negative shocks quickly. Since long-term institutions are

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more patient and less likely to exit a firm after a crisis, it is possible that they would use Responsive CSR to "weather the storm." We argue that the exit option is more likely for short-term IOs because they can more easily reduce their position size and they do not have a close relationship with management, so they have less of an option for voice. We expect a positive relationship between the firm's ex-post CSR score and institutional owner commitment, as measured by investor horizon or size. Fu et al. (2019); Gloßner (2019); Kim et al. (2019); Chen et al. (2020); and Shackleton et al. (2025) all document a positive relationship between investor commitment (investment horizon) and ex-ante Insurance CSR.

3 Data and Summary Statistics

We construct the net CSR score per firm from the MSCI ESG KLD database. The KLD database tracks CSR strengths and concerns by firm-year in the following seven areas: human rights, diversity, employee relations, environment, product characteristics, community relations, and governance. For each category, KLD assigns a binary score of 1 if a certain strength or concern is present in that area, and 0 otherwise.

In order to properly capture firm CSR usage intended to repair firm reputation, we follow prior literature (Godfrey et al. (2009); McCarthy, Oliver, and Song (2017)) and focus on the four areas defined as institutional CSR: human rights, diversity, environment, and community relations. Institutional CSR is a more appropriate measure of CSR designed to build reputation, as it focuses on the "softer side" of CSR. It represents a more purely altruistic motive without an apparent reciprocal demand from any stakeholders. In contrast, technical CSR (governance, product characteristics, and employee relations) represents social contracting with clear value-added benefits for the firm (Edmans (2011); Servaes and Tamayo (2013); Adhikari (2016)), and thus may

not be perceived as being conducted for altruistic purposes. For this reason, it has less ability to build reputational capital.

Total CSR strengths and total CSR concerns are calculated by summing the scores in each category, and we then compute the total CSR score for our institutional CSR measures as follows:

$$CSR_{i,t} = \sum CSR \text{ Category Strengths}_{i,t} - \sum CSR \text{ Category Concerns}_{i,t} \qquad (1)$$

where i and t represent firm and year, respectively. Our main sample excludes financials and utilities and ranges from 2001-2013. We begin our dataset in 2001 due to the expansion of coverage by KLD after 2000 to include the 1,000 largest U.S. companies in addition to the MSCI KLD 400 Social Index. We end our dataset in 2013 due to changes in the dataset construction after 2013.[6]

We collect SCA filing details (filing date, company name, settlement date, federal district court, etc.) from the Stanford Law School Securities Class Action Clearinghouse (SCAC) database. Their database averages about 200-250 cases per year. Using the provided company name and ticker symbol, we match to CRSP and Compustat by a combination of the ticker and a fuzzy matching algorithm by company name. From these potential matches, we then verify by hand that each match is correct. We also pull the original case filings and hand collect the name of the lead plaintiff in each case. We use this data in later sections to identify whether the lead plaintiff is an IO or whether it is an individual investor. In collecting lead plaintiff data, we further search for whether there are petitions or other attempts by IOs to become the lead plaintiff. We use this to identify whether IOs are actively concerned about the outcome of the case (i.e., it shows a monitoring effort by the IO).

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[6] Following several prior studies, we end our sample period in 2013 due to the acquisition of KLD by Morgan Stanley Capital International (MSCI) RiskMetrics Group. This created a discontinuity in the data and a severe methodological constraint to data homogeneity as highlighted by Derchi, Zoni, and Dossi (2021).

In addition to the Stanford SCAC data, we obtain additional legal data from the following three sources: (1) ease of litigation per federal district is obtained from surveys conducted by the Institute for Legal Reform of the U.S. Chamber of Commerce; (2) Universal Demand law incorporation states and the date of adoption of these laws is obtained from Appel (2019); and (3) Ninth Circuit Federal District incorporation states is obtained following Crane and Koch (2016).

We obtain other primary variables used in our study from four sources: 1) the Thompson-Reuters 13F institutional holdings database provides quarterly ownership reports for institutions with over $100 million in assets under management; (2) Brian Bushee's website provides classifications for various IO types in terms of investment horizon and other styles; (3) Compustat provides accounting and financial statement data; and (4) CRSP provides stock prices and return data. Finally, we gather data for our remaining tests from the following sources. We obtain board of director data from ISS Riskmetrics. We identify accounting violations based on Section 302 and Section 404 of SOX using Audit Analytics. We also obtain financial statement divergence (FSD) data from Zahn Bozanic's website. We use these accounting violations data for later tests involving the reputational capital of the firm.

3.1 Summary Statistics

Table 1 provides descriptive statistics for our main sample. All continuous variables are winsorized at the 1st and 99th percentiles. The mean net CSR score is about 0.13 (median = 0.00). Institutional holdings account for around 71% of total ownership of the firm. Following the classifications of Bushee (1998, 2001), 22% of institutional holdings are by transient (short-term) funds as opposed to 78% of holdings by dedicated/quasi-index (long-term) funds, and 71% of holdings are by independent funds as opposed to grey funds (those with multiple relationships). Institutional blockholders (institutions holding more than 5% of shares) are present in 94% of

observations. *Lawsuit Firm* indicates firm-years experiencing securities class action litigation, and they comprise 14% of the sample. About 7% of observations indicate financial statement weakness due to Section 302 of SOX, and 5% of observations indicate financial statement weakness due to Section 404 of SOX. Approximately 74% of board members are classified as outside directors, and the average director tenure is 8.91 years. Because the KLD dataset records CSR issues involving the 1,000 largest firms, our sample skews toward larger firms. For example, *Total Assets* averages $6.12 billion for our sample, while *Firm Size* (Market Cap) averages $7.91 billion.

4 Baseline Results, Identification, and Robustness

4.1 Baseline Regression Analysis

We first seek to confirm that firms engage in more CSR activities after they experience a serious reputational shock following prior literature (Krüger (2015). Specifically, we use the following model to test whether firms engage in more CSR activities after SCA lawsuits:

$$CSR_{i,t+1} = \beta_0 + \beta_1 \text{Lawsuit Firm}_{i,t} + \beta_2 \ln(\text{Total Assets}_{i,t}) + \beta_3 M/B_{i,t} \quad\quad (2)$$

$$+ \beta_4 \text{Leverage}_{i,t} + \beta_5 \text{ROA}_{i,t} + \beta_6 \text{Volatility}_{i,t} + \beta_8 \text{Capex}_{i,t}$$

$$+ \beta_9 \text{Cash Holding}_{i,t} + \beta_{10} \text{R\&D}_{i,t} + \varepsilon_{i,t}$$

where i and t represent firm and year, respectively. We define CSR as the sum of CSR strengths minus the sum of CSR concerns for each firm in a fiscal year. *Lawsuit Firm* is an indicator variable equal to one if a firm experiences an SCA lawsuit in a given year, and zero otherwise. We include control variables (defined in Appendix A) following prior CSR studies (Kotchen and Moon (2012) and Krüger (2015)). Gande and Lewis (2009) note that firms may anticipate legal filings, and there is an extensive literature indicating the use of Insurance CSR by firms facing greater reputational risks (Godfrey et al. (2009)). Therefore, we also include lagged one-year and two-year CSR in

some model specifications to control for abnormal levels of prior CSR. We cluster standard errors by firm, although results are robust to the more conservative approach of clustering by both firm and time (Petersen (2009); Thompson (2011)).

We report both ordinary least squares (OLS) and two-stage least squares (2SLS) regressions in Table 2. Panel A of Table 2 investigates the effect of lawsuits on CSR score in the current year (t), while Panel B investigates the effects in the following year (t+1). Columns 1 and 2 in both panels conduct baseline OLS tests. Results show that lawsuit initiation against a firm is positively and significantly associated with their CSR score in year t or t+1, evidence which is consistent with Responsive CSR. In terms of economic significance, the effect is about 5%, calculated as the coefficient on *Lawsuit Firm* divided by the total range of positive CSR score for our four institutional CSR measures.[7]

Note that lagged CSR score is highly significant in Column 2, indicating the presence of a significant ex-ante Insurance CSR effect. The effect of *Lawsuit Firm* on CSR is robust in Panels A and B to employing current year CSR or lagged CSR (t+1). We next perform multiple tests to address causality and potential endogeneity.

4.2   Identification Using Instrumental Variables and Propensity Score Matching

One concern in our study is reverse causality. Although we control for prior levels of CSR, it is possible a firm still depends on this past CSR score as an insurance policy to protect the firm, and it may decide it does not need Responsive CSR. Greater Insurance CSR may also indicate heightened litigation risk inherent to the firm prior to the lawsuit filing, identifying a selection problem. In addition, the significant financial costs imposed by the litigation event may make it

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[7] We use the range of CSR strengths instead of the total range because in unreported results we find the change in CSR is concentrated in an increase in CSR strengths, not a reduction in CSR concerns.

more difficult for the firm to embark on a costly Responsive CSR spending campaign to repair firm reputation.

We note in Figure 1 that our sample of SCA filings is spread roughly evenly across Fama-French 12 industries, suggesting there are no litigation biases favoring a particular industry. Nevertheless, in all models we include industry fixed effects to account for unobservable heterogeneity across industries in our sample. We also address endogeneity using two primary econometric methods. First, we utilize propensity score matching (PSM) to adjust for selection bias (Rosenbaum and Rubin (1985)) or other differences between lawsuit firms and non-lawsuit firms. We build our matched sample using a logit model with *Lawsuit Firm* as the dependent variable, and we include all control variables from Column 2 in Table 2. We then create a one-to-one nearest neighbor matched sample (without replacement) with a caliper width of 0.02 from non-SCA lawsuit firms in the same year and 2-digit SIC industry.[8]

As a second step to address endogeneity, we utilize two instrumental variables. Because our study focuses on federal securities class action litigation, we consider variation in litigation risk at the federal district court level using two IVs that proxy for litigation risk variation. Our first IV is *District Lawsuit Ease Index*, which measures the relative ease in which lawsuits can be filed against businesses per state.[9] This index is built by the U.S. Chamber of Commerce, which conducts surveys with businesses to determine how reasonable and fair the state's tort liability systems are toward companies. Our second IV is *District Lawsuit Experience*, which represents the total number of lawsuits in each district each year. Prior studies note that lawsuit experience is an important determinant for lawsuit filings, and many states have begun setting up special business courts to better handle cases (Dammann (2017)).

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[8] In untabulated results, we verify that there are no statistically significant differences between our lawsuit and non-lawsuit sample post-match.

[9] We create a district measure from the population-weighted average of each state score.

Column 3 of Table 2 reports the PSM results, which are weaker than the base sample, though consistent in sign. Column 4 in Panel A examines the validity of our two IVs in the first stage of the two-stage least squares regression, adding all the controls and including the lagged CSR variables. Each IV is positive and statistically significant, and our F-statistic of 15.85 indicates the two IVs are not jointly weak. Columns 5 and 6 in Panel A demonstrate that *Instr Lawsuit Firm* is highly significant whether we employ the full sample or the PSM sample. The result is robust in Panel B of Table 2 where we use lagged CSR as the dependent variable. The effect of SCA lawsuits on current and subsequent CSR scores is robust to multiple model specifications.

5   Is the Effect Consistent with Damage Control?

The building of reputational capital is an inherently lengthy process. It takes time and sizeable investments to establish trust and loyalty with stakeholders (customers, investors, communities, government agencies, etc.). Having a strong reputation provides significant firm benefits and helps to retain institutional investors (Gillan et al. (2021)). However, it can be easily and quickly lost through bad corporate handling of reputational shocks (e.g., the BP oil spill as examined in Dyck et al. (2019) and Fu et al. (2019)), and as our results above demonstrate, firms increase their CSR scores after a lawsuit has been filed against them.

We argue that Responsive CSR should be used more extensively in firms that possess high levels of reputational capital prior to the crisis event. First, firms need to quickly counter reputational shocks to maintain strong reputational capital (Wilson (2008)). Second, the firm can use reputational capital to reduce stakeholder penalties after a negative reputational shock (Cohen and Gurun (2018)) and thus would want to strive to maintain their reputations. Third, firms that have weak reputations or that have faced recent reputational damage may benefit less from the use

of Responsive CSR (Gande and Lewis (2009)). Thus, in contrast, they would not likely engage more in Responsive CSR.

We address this question by examining the CSR scores of firms with lower reputational capital as identified by three measures of ex-ante financial statement risk.[10] First, we split the sample into high and low quantiles by firm-year based on the Financial Statement Divergence (FSD) score of Amiram et al. (2015).[11] High scores indicate potential inaccuracies and a weakness in financial statement credibility. Second, we split the sample by firm-year by the presence of manager-based internal control material weakness (ICMW) following Hoitash et al. (2012) and based on section 302 of SOX using data provided by Audit Analytics. Third, we split the sample by firm-year by the presence of auditor-based ICMWs based on section 404 of SOX, again following Hoitash et al. (2012) using data provided by Audit Analytics. We create the binary variable *High Weakness* for each of these three categories, and we expect coefficient estimates to be higher in the *Low Weakness* group. Table 5 reports these results.

Overall, in Columns 1-3 of Table 5 we find that Responsive CSR usage is positive and statistically significant only in the *Low Weakness* group. We then refine these measures by combining them as follows. In Column 4 we create a strict filter requiring violations in all three categories to indicate *High Weakness*, and no violations in any of the three categories to indicate *Low Weakness*. In Column 5, we create a more relaxed filter where firms with a violation in only one category are coded as *High Weakness*, and *Low Weakness* otherwise. The coefficient estimates on *Lawsuit Firm* are even stronger in these two models for the *Low Weakness* group, and Wald

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[10] Insurance CSR score by itself cannot be easily used as a proxy for strong reputational capital, as it both builds firm reputation and is endogenously associated with pre-trigger event risk. That is, it is often used by firms that face higher than normal ex-ante reputational risks or that seek to repair previously damaged reputations (Gande and Lewis (2009)). In addition, insurance CSR represents an "income statement" expenditure, whereas reputational capital relates more to a "balance sheet" asset. For that reason, we focus on pre-shock risk indicators that do not have this endogenous relationship.

[11] We thank Zahn Bozanic for making this data available.

tests suggest coefficient differences between the subsamples are statistically significant. We conclude that Responsive CSR is employed overwhelmingly by firms with little or no material weaknesses in their financial statements, which we interpret as being consistent with high-reputation firms engaging more in damage control (Responsive CSR) after a crisis event.

6 Moderating Environments

6.1 Responsive CSR and the Legal Environment

We have demonstrated that firms respond to lawsuits by increasing their CSR scores in the current and following year. To provide further robustness to our results, we next examine legal and corporate settings in which we believe the effects we find in our baseline results will be enhanced. First, there are legal environments in which we believe the need for "damage control" will be more prevalent because the likelihood of engaging in a lengthy court battle is enhanced. Perhaps more importantly in these legal settings, both the probability of losing and the penalties incurred for losing are enhanced.

First, we exclude firms incorporated in what are called "Universal Demand (UD) law" states. Since 1989, twenty-three states have passed UD laws that require plaintiffs in a (financial) lawsuit to approach the board of directors and make a "demand" that they address their complaints. This contrasts with the other twenty-seven states that allow "demand futility" where disgruntled investors can bypass the board and go straight to a judge. Since most lawsuits in UD law states are dismissed, the presence of UD laws represents a significant reduction in litigation risk (Davis (2008); Appel (2019)).

Second, we exclude firms incorporated in the Ninth Federal District. The 1999 Silicon Graphics ruling in the Ninth Circuit reduced litigation risk in firms incorporated in Ninth District

states just prior to our sample period. This ruling requires evidence of deliberate recklessness on the part of management for the case to proceed to the discovery stage of a securities lawsuit investigation. Since most evidence on managerial malfeasance is found during discovery, this ruling creates a significant barrier to SCA litigation moving forward (Crane and Koch (2016)).

Third, we exclude firms headquartered in the top ten most business-friendly states for legal challenges. The U.S. Chamber of Commerce Institute for Legal Reform (ILR) conducts surveys to rank states on how reasonable their tort liability systems are perceived to be by U.S. businesses.[12] High-ranking states are deemed as more business friendly, and as such would present fewer legal problems to businesses. A finding that the effect of lawsuits on CSR is stronger in states where litigation has a higher probability of succeeding would add credence to our findings in Table 2.

In Panel A of Table 3, we reexamine our baseline results excluding firms that face lower litigation risk. Since these excluded low-litigation environments would present less need for Responsive CSR to counter litigation risk, the exclusion of these firms should increase the magnitude of our coefficient estimates on *Lawsuit Firm*. We thus predict that *Lawsuit Firm* coefficient estimates in Table 3 should be larger than our benchmark coefficient estimate of 0.185 in Column 2 of Table 2 (Panel B).

Indeed, we find that for all three cases the magnitude of our coefficient on *Lawsuit Firm* is larger by 10-20% than our benchmark baseline coefficient estimate of 0.185. In Panel B of Table 3, we further refine this test and allow one or more exclusions to create a "More Business Friendly" group, as opposed to a group where no exclusions from any of our three screens exists. Our coefficient estimate for the "Less Business Friendly" group is even stronger using this test.

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[12] This is the same measure that is used for our IV, although it is simply used as a filter in this case and is not used in the 2SLS model here. We use the 2004 survey to avoid any bias due to annual changes. Results are robust to using other years or allowing changes from year to year.

Therefore, we conclude that the effect of lawsuits on subsequent CSR scores is greater in high-litigation states, which is consistent with our a priori prediction and which strengthens our previous findings.

6.2 Responsive CSR and the Corporate Environment

Similar to our tests above in legal settings, we now investigate settings in which the firm may be less concerned with CSR scores after a lawsuit because there is no outside pressure on the firm to react. Managers may not always seek to mitigate the impact of a lawsuit for several reasons. First, the pre-crisis managers are often terminated after a crisis from a lawsuit, and their successors may be unwilling to pursue a costly CSR campaign to reduce the damage that reflects primarily on prior management. Second, entrenched managers may not be concerned about temporary shocks. In this section, we provide further robustness to our main results by excluding circumstances that reduce the ability of institutional owners to exert pressure on managers.

We examine reduced pressure by IOs in three ways. First, we identify the presence of a dual class share structure that allows a small class of shareholders to possess dominant voting rights and reduces the ability of IOs to discipline management (e.g., Baran and Forst (2015)). Second, we identify the presence of a classified (staggered) board structure that prevents the quick replacement of directors, thus reducing the ability of activist IOs to rapidly initiate a damage control strategy after a crisis event. Third, we identify lawsuits that have an institutional owner as the lead plaintiff, which have been shown to be less likely to be dismissed, to have larger settlement amounts, and to ultimately result in greater board independence after the conclusion of the lawsuit (Cheng, Huang, Li, and Lobo (2010)). In all three of these settings, we would expect less use of Responsive CSR.

In Table 4 Panel A, we reexamine our baseline OLS results excluding firms that face less monitoring pressure from their institutional owners in each of the three settings identified above. Because these exclusions should increase the ability (or willingness, in the case of lead plaintiffs) of IOs to monitor their directors/managers and encourage the initiation of Responsive CSR, we predict that *Lawsuit Firm* coefficient estimates in Panel A of Table 4 should be larger than our benchmark coefficient estimate of 0.185 in Column 2 of Table 2 (Panel B).

In Panel A of Table 4, we see that the coefficient estimates are larger than 0.185 in only the case of excluding classified board firms. Indeed, the coefficient estimate for excluding individual lead plaintiffs is smaller than 0.185.[13] However, in Panel B we combine these filters to create a "Weak Monitoring" group if there is the presence of any of these conditions. In contrast, the "Strong Monitoring" group will not have any of these monitoring barriers and should have greater Responsive CSR. Indeed, we find that our coefficient estimate of 0.255 for the "Strong Monitoring" group in Panel B is almost 38% greater than our benchmark coefficient estimate of 0.185. We conclude from the results that Responsive CSR is higher where institutional owners have more ability to influence management (after a crisis). We next turn to the characteristics of institutional owners and their incentives to exert pressure on management.

7   Responsive CSR and Institutional Owner Commitment

We argue there are two important characteristics of institutional owners that influence their incentives to monitor the firm and push the firm to engage in long-term firm value creation and reputation enhancement. First, there is the horizon of the institutional owner – those IOs with long-term horizons have incentives to push the firm to engage in CSR for damage control after a crisis

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[13] We deem the lead plaintiff exclusion inconclusive because most of the plaintiff data we hand-collected had IOs as the lead plaintiff, leaving only a small number of individual lead plaintiff SCAs to exclude.

event. Furthermore, there is the size of the investment. We argue these IO characteristics measure the IO's commitment to the firm, and we examine each of these two characteristics next.

7.1   Responsive CSR and Long-Horizon IOs – The Bushee Measure

We first examine the impact of investor horizon by simply examining the change in long-term vs. short-term IO holdings in the years before and after a lawsuit filing. Figure 2 depicts this comparison, where in Panel A we use two distinct measures of IO holding period length built from the classifications of Bushee (1998, 2001). We find an increase in firms with majority long-term holdings after an SCA filing versus firms with majority short-term holdings using the adjusted long-term ratio (explained in detail later). This ratio shows an increase from around 0.35 in the year before an SCA filing to over 0.5 in the year after the filing. For contrast, the adjusted short-term ratio is built differently, utilizing a short-term continuous variable indicating the percentage of transient IO investment in transient firms.[14] It shows a decrease from year (t-1) to year (t+1). We further plot the difference between these two ratios in Panel B of Figure 2. There is a relatively stable trend of IO holdings in the years before and the years after a lawsuit filing, with a large increase in long-term IOs (decrease in short-term IOs) in the year before and the year of a filing.[15] This evidence is consistent with long-term investors increasing their relative exposure after a crisis, but we next turn to regression analysis.

We first perform a univariate regression analysis in Panel A of Table 5 to determine whether there is a different response based on IO investor horizon. In this panel we examine the

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[14] This contrasts with the categorical variable (1 for majority long-term firms, 0 for majority short-term firms) used for the adjusted long-term ratio. In addition, the adjusted long-term ratio uses the permanent classification system of Bushee (1998, 2001), whereas the adjusted short-term ratio uses the variable classification system. Both ratios are scaled by the mean values of these ratios over all firms in that year.

[15] It is not exactly clear why transient IOs reduce their positions in the year before an SCA filing. However, transient investors tend to react strongly negatively to reputational shock trigger events and sell within days (Krüger (2015)), and this trigger event precedes our SCA filing measure by one to two months, potentially placing many events in the prior fiscal year.

impact of an SCA filing on the ratio of long-term IO holdings (dedicated and quasi-index) to short-term IO holdings (transient) based on the classifications of Bushee (1998, 2001), which we call the long-term ratio. We find that long-term holdings increase relative to short-term holdings in the lawsuit year and for the two years following.

We examine this further using multivariate analysis in Panel B of Table 5. In Columns 1 through 4 of Panel B we repeat the OLS full sample regressions of Table 2 using varying levels of controls, and we split our sample by firm-year into high and low quartiles or quantiles based on the percentage of IO long-term investments (dedicated or quasi-index funds). We find positive and statistically significant results on *Lawsuit Firm* in all four models for the long-term groups. The short-term quantile model using only lagged CSR controls at year (t-1) and (t-2) is also significant, but lower in magnitude than the long-term results. Wald tests indicate the two coefficients are statistically different. Columns 5 and 6 of Panel B in Table 5 replicate the models in Table 2 but now splits the sample by firm-year into high and low quantiles based on the IO long-term investment percentage. Coefficient estimates for *Instrumented Lawsuit Firm* are larger and exhibit positive statistical significance in both the full and PSM samples. Overall, these results provide strong support that it is the long-term institutional owners who exert pressure on firm management to invest in damage control (Responsive CSR) after a crisis.

7.2   Responsive CSR and Long-Horizon IOs – The Churn Measure

We next examine an alternative proxy for investor horizon by building a "flow robust churn measure" following Yan and Zhang (2009). Their methodology classifies IOs into short-, medium-, and long-term investors based on their portfolio turnover in the prior four quarters.[16] We follow

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[16] Gaspar, Massa, and Matos (2005) produce a similar churn measure that uses the sum of aggregate purchases and sales in the prior four quarters. Yan and Zhang (2009) explain that their measure represents an improvement, as it

prior related papers (Yan and Zhang (2009); Fu et al. (2019)) and separate firms into three terciles based on their rate of portfolio churn: Short-Term, Mid-Term, and Long-Term. Columns 1 through 3 in Panel A of Table 6 examines the impact of an SCA filing on CSR in each of these terciles using our OLS model from Table 2. We find that *Lawsuit Firm* is positively significant only in the Mid-Term and Long-Term categories. Furthermore, we note an increasing progression of coefficient size and significance as the terciles increase from Short-Term to Long-Term. Columns 4 through 6 repeat the second stage of our 2SLS model from Table 2, and we again find positive and significant results only in the Mid-Term and Long-Term categories, and we note a similar progression of increasing coefficient size and significance as the terciles increase from Short-Term to Long-Term. This evidence corroborates the studies on ex-ante Insurance CSR found in Fu et al. (2019); Gloßner (2019); Kim et al. (2019); Chen et al. (2020); and Shackleton et al. (2025). It is the long-horizon institutional owners that influence firms to employ CSR as damage control after an incident.

7.3 Responsive CSR and IO Investment Size

We next examine whether IOs impact firms only when the firms are held by institutions that are more committed to the firm because of the size of their investment. Although no other IO blockholder studies to our knowledge examine Responsive CSR, several studies find a relationship between blockholder monitoring and Insurance CSR. Chen et al. (2020) find that IOs prefer to reduce negative CSR issues that could lead to lawsuits or regulatory penalties, and they note that IOs use their large stakes to encourage firms to increase CSR. Similarly, Buchanan, Cao, and Chen (2018) find that IOs promote a positive relationship between CSR and value, as their monitoring

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minimizes the impact of investor cash flow by using the *minimum* of aggregate purchases and sales instead of the sum. For robustness, we also employed the Gaspar et al. (2005) churn rate methodology and obtained similar results.

mitigates agency concerns and the potential for overinvestment in CSR. Gloßner (2019) finds that large blockholders monitor their firms to ensure a focused CSR strategy that helps avoid costly incidents. Relatedly, Kim et al. (2019) find that long-term IOs have more incentives to monitor their firms, leading to more CSR.

In this section we determine whether IOs with sizeable stakes in the firm encourage firms to invest in damage control via Responsive CSR. In Table 9 we proxy for investment size in two ways. First, we proxy for the size of IO investments by simply using the market capitalization of the lawsuit firm. Ceteris paribus, firms that are larger have a larger investor base and larger holdings by their IOs. Second, we refine this measure by creating an interaction term between market cap and the ratio of IO holdings in a firm to total firm ownership. A large firm with a high IO holdings ratio will have either 1) a greater number of institutional owners to collectively exert influence, or 2) larger holding amounts per institutional investor (encouraging more pressure by these IOs).

Columns 1 and 2 of Table 9 split the full sample by firm-year into the bottom three quartiles and top quartile by market cap, respectively, and repeat the baseline regressions of Table 2. The coefficient estimate on *Lawsuit Firm* is positive and significant at the 1% level in the *High Group*, while it is insignificant in the *Low Group*. In addition, Wald tests demonstrate that coefficient differences between the subsamples are statistically significant. We repeat these regressions in Columns 3 and 4, splitting the full sample by firm-year by the interaction term *Investment Size x IO*, which multiplies market cap by the ratio of institutional ownership in the firm. We find similar and stronger results using this more refined proxy for IO investment size. The coefficient estimate for *Lawsuit Firm* in the *High Group* is larger and statistically significant, and Wald tests showing a difference in coefficient estimates between the subsamples are even stronger. Columns 5 through 8 repeat these regressions using the 2SLS model. Although not as strong, coefficient estimates are

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positive and more significant in the *High Group* using both proxies for investment size, suggesting stronger commitment by IOs leads to greater Responsive CSR usage after an SCA filing.

7.4   Responsive CSR and the Interaction between Investor Size and Horizon

In Table 10 we build on our findings from Table 9 and examine three additional measures of IO commitment, but we do so only in the sample of long-horizon institutional investors. To do this, we first split the sample into quantiles by firm-year based on the long-term ratio defined in Bushee (1998, 2001). We then employ only the observations in the top quantile of long-term investors to run the next set of regressions, so that we are confined only to the longest-horizon institutional owners. We then use this long-horizon sample to examine IO commitment via the holdings in the firm, and we measure investor commitment via firm holdings in three ways.

First, we determine whether there is at least one blockholder IO in the firm. We define *Blockholder Pres* as 1 if at least one IO holding 5% or more of the firm's shares is present, and 0 otherwise.[17] Second, we split the sample by firm-year into quintiles by IO concentration percent. We define *Concentration* as the average percent ownership by IOs using a Herfindahl-type index of the amounts held by all the IOs present in the firm. A high percentage represents domination by a few select IOs. These IOs are expected to be more committed, given their significant allocation to the firm. We classify the top quintile as firms with High Concentration, while the bottom four quintiles indicate firms with Low Concentration. Third, we split the sample by firm-year into quintiles by the maximum percentage of shares held by any IO. We classify the top quintile as firms with high *Max % Held*, indicating the firm is likely dominated by one or a few large IO holdings. The bottom four quintiles indicate low *Max % Held*. We find that the impact of *Lawsuit*

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[17] Note from our descriptive statistics that a blockholder is present in 94% of the observations.

Firm on CSR is economically more significant in the high-commitment group employing any of these three measures.

Finally, in Panel B of Table 10, we examine "grey" institutional investors versus independent IOs. Grey institutions (Brickley, Lease, and Smith (1988)) that have multiple relationships with a firm are inherently long-term investors and have less ability to reduce equity holdings after a crisis for fear of endangering their other relationships. This suggests they are more likely than independent institutions to "stay the course and weather the storm" by remaining with the firm, and thus they potentially encourage the use of Responsive CSR. When we employ grey institutions as the measure of long-term incentives rather than the IO horizon, we again find that the impact of *Lawsuit Firm* on CSR is economically more significant in the high-commitment group.

8   Conclusion

This study examines the use of ex-post CSR, or what the finance literature calls "Responsive CSR," to mitigate the filing of a class action lawsuit against the firm. These SCA lawsuits are typically the first stakeholder action to be filed after a triggering event that sparks a cascade of related lawsuits and government investigations. Thus, SCAs closely measure when the triggering event causes reputational damage to the firm. Our results demonstrate robustly that firms raise their CSR scores in the year of and year following an SCA filing. We address endogeneity via several methods, including two-stage least squares regressions with instrumental variables affecting litigation risk, and by utilizing a propensity score matched sample. Our results are robust to these approaches.

We then demonstrate that the effect is consistent with damage control, or reputation repair, by examining the effect of reputational capital on ex-post CSR use. Firms with low reputations

have no reputation to repair after a crisis. We find that it is the firms with the higher reputations that raise their CSR scores after the crisis. We next examine legal and corporate settings in which we believe the effect will be stronger. For firms in "business-friendly states" with a low likelihood for lawsuit success, we find the effect is weakened. Furthermore, in corporate settings where investors have little voice for shareholder activism, as in firms with staggered boards and dual class shares, the effect is also weakened. The CSR score is positively influenced only where the firm must consider the chance of losing the lawsuit and where institutional owners can affect change at the firm.

In that regard, we next examine whether investor commitment to the firm influences the firm's CSR score post-crisis. We identify committed investors as those with long-term investment horizons, those with significant stakes in the firm, as blockholders, or as IOs with multiple relationships with the firm. We find that institutional owner commitment is a key component to a firm's use of CSR after a crisis. The presence of long-horizon institutional owners with a significant stake in the firm drive the use of CSR by firms after a securities class action lawsuit. We conclude that the characteristics of institutional owners play a significant role in the use of Responsive CSR by firms after a crisis. Our findings contribute to the debate over the use of CSR and the effect that institutional owner commitment has on such use.

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Appendix A
Variable Descriptions

KLD CSR Score Measures and Lawsuit Variables

Net CSR	∑CSR Strengths - ∑CSR Concerns. *From MSCI ESG KLD.*
CSR Strengths (Concerns)	Sum of strength (concern) scores for community, diversity, environment, and human rights components. *From MSCI ESG KLD.*
Lawsuit Firm	Indicator variable that equals one if a firm experiences any securities class action lawsuits where the settlement is at least $1 million during the fiscal year. *From Stanford Securities Class Action Lawsuit Clearinghouse.*
District Lawsuit Ease Index	Population weighted average per U.S. federal district of state scores from 1 to 50, where 1 indicates the most difficult state to sue a company and 50 indicates the easiest state to sue a firm. *The Institute for Legal Reform of the U.S. Chamber of Commerce provides the overall ranking of state liability systems.*
District Lawsuit Experience	Total number of corporate lawsuits occurring in each U.S. federal district in a given year. *From Audit Analytics.*
Instrumented Lawsuit Firm	Predicted probability of a firm being involved in securities class action litigation using the District Lawsuit Ease Index and the District Lawsuit Experience Index.
UD Law	Indicator variable equal to one if the firm's state of incorporation passed Universal Demand Laws (UD) in year t or prior, and zero otherwise. *From Appel (2019).*
Ninth Circuit	Indicator variable which equals one if a firm's headquarters is located within the jurisdiction of the Ninth Circuit U.S. Court of Appeals, and zero otherwise. *From Crane and Koch (2016).*
ILR Rank	Rank of the 50 US states and the District of Columbia by the 2004 legal climate survey of the U.S. Chamber of Commerce Institute for Legal Reform (ILR). A higher ranking corresponds to a more business friendly legal environment.

Institutional Ownership Measures

Inst. Holdings (%)	Ratio of ownership by financial institutions to total ownership. *From Thompson-Reuters Financial.*
Long-Term Ratio	Percent of firm ownership in dedicated or quasi-index institutions (long term) to total institutional ownership (long term institutions plus transient institutions (short term)). *From Bushee (1998, 2001).*
Churn Measure	The weighted average of the average total portfolio churn (turnover) rates of institutional investors holding the firm over the past four quarters. *From Gaspar, Massa, and Matos (2005).*
Flow Robust Churn Measure	Churn measure minimizing the impact of investor flow by substituting the minimum of aggregate purchase and sales for the sum of aggregate purchases and sales. *From Yan and Zhang (2009).*
Grey vs. Independent	Percent of firm ownership in grey institutions (banks, insurance companies, private pension funds) versus independent institutions (independent investment advisors, investment companies, public pension funds). *From Brickley, Lease, and Smith (1988).*

Blockholder Presence	Indicator variable equal to 1 if any institution owns 5% or more of the firm's shares during the year; 0 otherwise.
Concentration %	Average percent ownership of the firm by each institutional investor, based on a Herfindahl index of the various IO holding amounts held. High percentages represent firms held by few institutions with large percentage holdings, while low percentages represent dispersed ownership with small percentage holdings held by many institutions.
Max % Held	Maximum amount of institutional holdings held by any institutional owner of the firm, divided by the total amount of firm institutional holdings.
Manager Concentration	For the institutional owner with the largest holding in the firm, this is the Herfindahl index of that manager's portfolio considering all firms in which they are invested.
Lead Plaintiff	Indicator variable equal to one if a firm facing a securities class action lawsuit filing in year (t) has an institutional owner as the lead plaintiff in the case, zero if the lead plaintiff is an individual investor, and missing otherwise. *Similar to Crutchley, Minnick, and Schorno (2015).*

Additional Variables	
Log(Total Assets)	Natural log of total assets: log (at). *From Compustat.*
Leverage	Book leverage: (dltt+dlc)/at. *From Compustat.*
ROA	Net Income/Book Assets: ni/at. *From Compustat.*
Stock Volatility	Standard deviation of daily stock returns for the prior 12 months. *From CSRP.*
Market to Book	(Market value of common stock + total debt + preferred stock – deferred taxes and investment tax credit) / total assets: (prcc_f×csho +dlc + dltt +pstkl – txditc)/at. *From CSRP and Compustat.*
Capital Exp. (%)	Ratio of year-end capital expenditure over year-end total assets: (capex/at). *From Compustat.*
Cash Holdings (%)	Ratio of year-end cash and cash equivalents over total assets: che/at. *From Compustat.*
R&D Exp. (%)	Ratio of year-end R&D expenditures over total assets: (max(0, xrd)/at). *From Compustat.*
Independent Directors (%)	Percent independent directors: (number of independent directors/total number of directors on board). *From ISS (formerly RiskMetrics).*
% of Outside Directors	Total number of outside directors on the board divided by board size. *From ISS (formerly RiskMetrics).*
Avg Director Tenure	Average tenure of all directors on the board in a given year. *From ISS (formerly RiskMetrics).*
Financial Statement Divergence (FSD)	The mean absolute deviation of leading digits in financial statements from the theoretical distribution predicted by Benford's Law. *Dataset from Zahn Bozanic following Amiram, Bozanic, and Rouen (2015).*
SOX 302 Weakness	Indicator variable equal to one if one or more manager-based internal control material weaknesses (ICMW) are recorded for the year; zero otherwise. Based on Section 302 of Sarbanes Oxley. *From Audit Analytics following Hoitash, Hoitash, and Johnstone (2012).*

SOX 404 Weakness	Indicator variable equal to one if one or more auditor-based internal control material weaknesses (ICMW) are recorded for the year; zero otherwise. Based on Section 404 of SOX. *From Audit Analytics following Hoitash, Hoitash, and Johnstone (2012).*
Dual Class	Indicator variable equal to one for any firm that established multiple share classes at their IPO and has not reclassified back into a single class share structure; zero otherwise. *Dataset from Lindsay Baran and Arno Forst following Baran and Forst (2015).*
Classified Board	Indicator variable equal to one if board members belong to different classes, serving staggered and overlapping terms that are elected in different years. *From Gompers, Ishii, and Metrick (2003).*

Figure 1
Securities Class Action Filings by Fama French 12 Industry

This figure presents the percentage of firm-year observations by Fama-French 12 industry of securities class action filings for our sample between 2001 and 2013. The financial and utility industries are excluded from the sample.

SCA Filings Percentages per Fama French 12 Industry
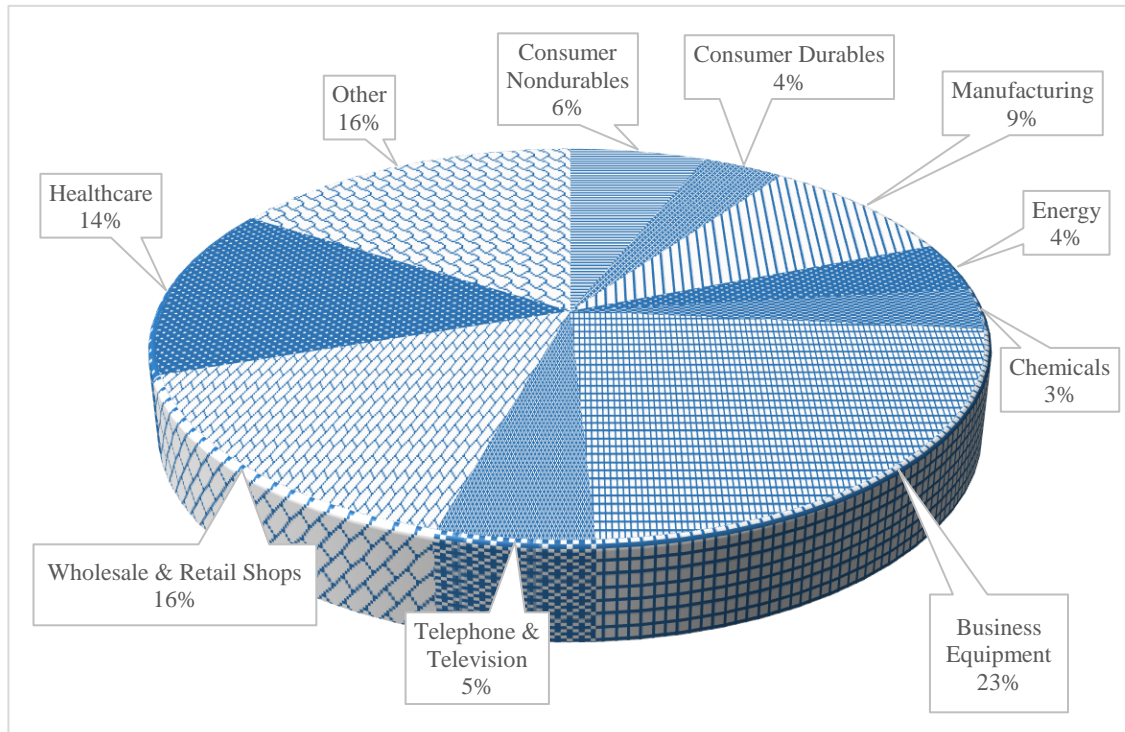
Figure 2
Long Term Institutional Holding Trends Around an SCA Filing

This figure shows investment trends by long term and short-term institutional owners in the three years before and after an SCA filing. In Panel A, the adjusted long term ratio (Adj LT Ratio) is calculated by first determining the ratio of SCA firms with over 50% of their institutional holdings in dedicated or quasi-index funds (permanent class) to firms with over 50% of their institutional holdings in transient funds following Bushee (1998, 2001). The ratio is then scaled by subtracting the mean of this measure for both SCA and non-SCA firms per fiscal year. The adjusted short term ratio (Adj ST Ratio) is calculated by first determining the percent of transient institutional holdings (variable class, more or less than 50%) compared to total institutional holdings for SCA firms following Bushee (1998, 2001). The ratio is then scaled by subtracting the mean of this measure for both SCA and non-SCA firms per fiscal year. Panel B plots the difference in the adjusted long-term ratio and the adjusted short-term ratio.

Panel A: Institutional Holding Ratios
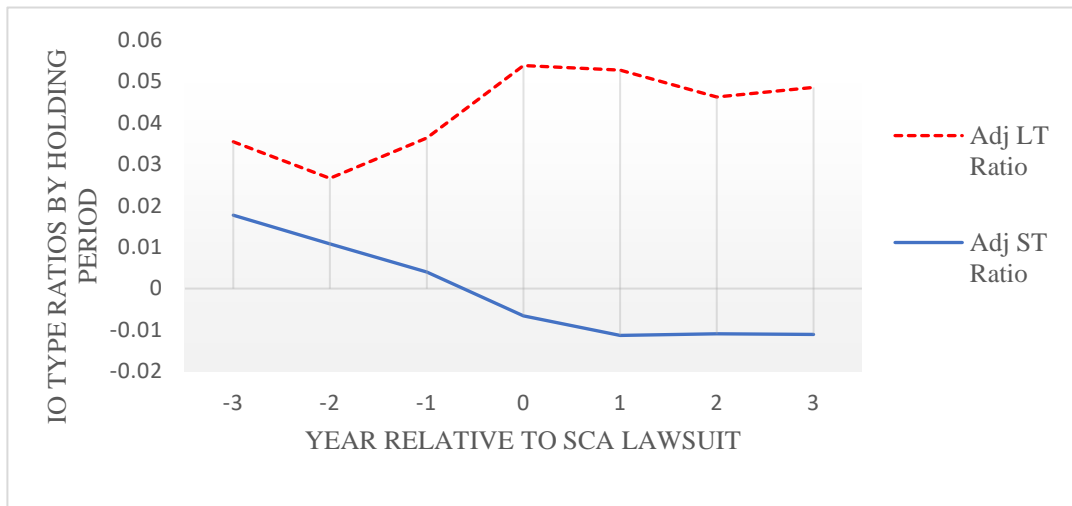
Panel B: Long Term Minus Short Term Ratio

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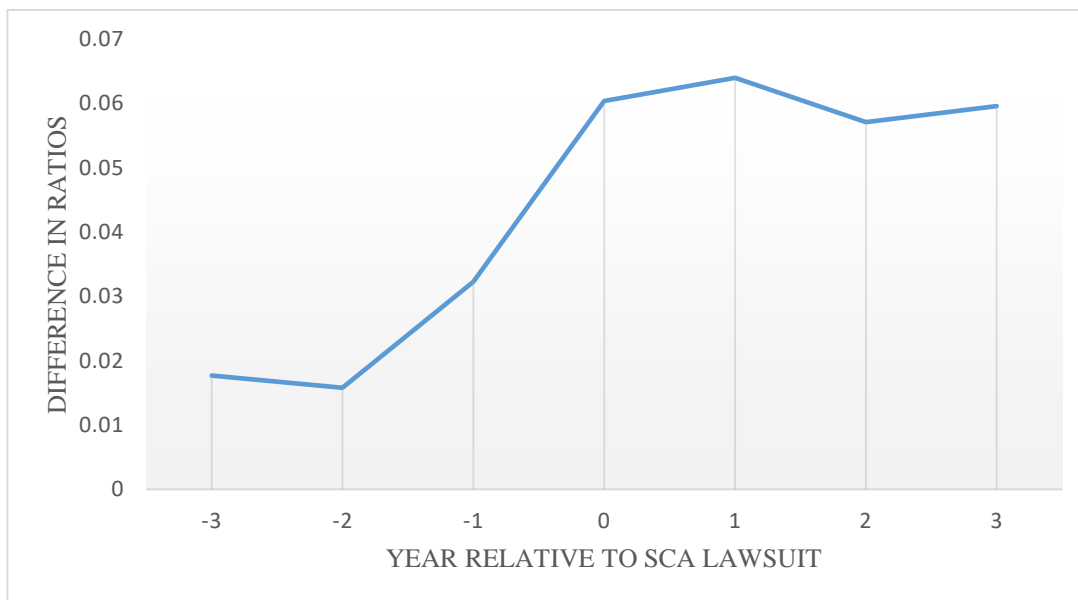
Table 1
Summary Statistics

This table reports the descriptive statistics for firms with SCA lawsuits and those with no SCA lawsuits for our sample. The full sample consists of 14,198 firm-year observations between fiscal year 2001 and 2013. All variables are described in Appendix A.

Variables	N	Mean	Std. Dev	25% Perc.	Median	75% Perc.
Net CSR	14,198	0.13	2.44	-1.00	0.00	1.00
Lawsuit Firm	14,198	0.14	0.34	0.00	0.00	0.00
Total Assets ($ mil)	14,198	6,116.00	11,753.04	635.09	1,689.27	5,128.42
Market-to-book	14,198	3.20	18.75	1.50	2.25	3.58
Leverage	14,198	0.21	0.18	0.04	0.20	0.33
ROA	14,198	0.14	0.10	0.09	0.13	0.18
Volatility	14,198	1.33	36.13	0.15	0.27	0.45
Capital Exp.	14,198	0.05	0.05	0.02	0.04	0.06
Cash Holdings Ratio	14,198	0.31	1.68	0.01	0.05	0.20
R&D Exp.	14,198	0.03	0.05	0.00	0.00	0.04
Inst. Ownership	14,198	0.71	2.29	0.59	0.78	0.89
District Lawsuit Ease Index	13,854	19.83	8.92	12.00	20.00	27.00
District lawsuit Experience	13,854	10.00	5.41	6.00	9.00	12.00
Firm Size (Market Cap, $ mil)	14,198	7,910.18	25,473.57	704.32	1,742.62	5,019.06
Financial Statement Divergence	14,198	0.03	0.01	0.02	0.03	0.03
SOX 302 Manager Weakness	13,230	0.07	0.25	0.00	0.00	0.00
SOX 404 Manager Weakness	10,789	0.05	0.22	0.00	0.00	0.00
Long Term Ratio	14,160	0.78	0.10	0.72	0.79	0.85
% Outside Director	11,208	0.74	0.14	0.67	0.78	0.86
Avg Director Tenure	11,208	8.91	13.53	6.13	8.18	10.72
Investor Flow Adj Churn Measure	11,183	0.07	0.01	0.06	0.07	0.08
Grey vs. Indep.	14,160	0.29	0.10	0.22	0.28	0.35
Blockholder Presence	11,190	0.94	0.22	1.00	1.00	1.00
Concentration %	14,160	0.05	0.03	0.03	0.04	0.06
Max % Held	14,160	0.13	0.06	0.09	0.12	0.15

Table 2
Table 2
Responsive CSR after a Securities Class Action Lawsuit

This table examines the relationship between SCA filings and ex-post net CSR score. Panel A examines the impact on CSR score in year (t), while panel B examines the impact in year (t+1). Models (1) and (2) use OLS regressions of the full sample, while model (3) uses a PSM sample. All three models use net CSR as the dependent variable and use varying levels of controls. Model (4) presents first-stage regression results using the *Lawsuit Ease Index* and the *Lawsuit Experience Index* as instruments for lawsuit probability. Model (5) uses the instrumented lawsuit firm variable from model (4) in a 2SLS model similar to model (2). Model (6) repeats model (5) for the PSM sample. Variable definitions are reported in Appendix A, and continuous variables are winsorized at the 1% and 99% level. Controls, industry, and year fixed effects are applied as specified, p-values are reported in parentheses, and robust standard errors are clustered by firm. *,**,*** represent significance at the 10%, 5%, and 1% level, respectively.

				1st Stage	2nd Stage	
	OLS Full		OLS PSM	2SLS Full	2SLS Full	2SLS PSM
Panel A. Dependent Variable at Time (t)	Net CSR $_t$		Net CSR $_t$	Lawsuit Firm $_t$	Net CSR $_t$	
	(1)	(2)	(3)	(4)	(5)	(6)
Lawsuit Firm $_t$	0.266**	0.199***	0.163*			
	(0.039)	(0.002)	(0.057)			
Lawsuit Ease Index $_t$				0.006**		
				(0.013)		
Lawsuit Exper Index $_t$				0.074***		
				(0.002)		
Instr Lawsuit Firm $_t$					2.211***	5.477***
					(0.001)	(0.000)
Log (total assets) $_t$	0.730***	0.174***		0.026***	0.155***	0.125***
	(0.000)	(0.000)		(0.000)	(0.000)	(0.002)
Market-to-book $_t$	0.676***	0.167***		0.019***	0.032***	0.036
	(0.000)	(0.000)		(0.000)	(0.002)	(0.171)
Book leverage $_t$	-1.223***	-0.228***		-0.030***	-0.034	-0.048
	(0.000)	(0.000)		(0.006)	(0.567)	(-0.320)
ROA $_t$	0.102	-0.0208		-0.025*	0.024	-0.358
	(0.635)	(0.817)		(0.099)	(0.834)	(0.290)
Volatility $_t$	0.530***	0.042		0.036**	-0.085***	-0.054
	(0.004)	(0.736)		(0.013)	(0.007)	(0.505)
Capital Exp. $_t$	1.372**	0.452**		0.073*	0.115	1.489**
	(0.048)	(0.024)		(0.074)	(0.658)	(0.040)
Cash holdings $_t$	-0.366***	-0.035		0.021	0.117	-0.208
	(0.004)	(0.720)		(0.188)	(0.156)	(0.410)
R&D Exp. $_t$	1.246**	0.387***		0.010	0.215	-0.273
	(0.020)	(0.009)		(0.723)	(0.395)	(0.776)
Net CSR $_{t-1}$		0.890***	0.929***	-0.003*	0.889***	0.855***
		(0.000)	(0.000)	(0.080)	(0.000)	(0.000)
Net CSR $_{t-2}$		0.011	0.032	0.002	0.022	0.036

	(1)	(2)	(3)	(4)	(5)	(6)
		(0.261)	(0.296)	(0.377)	(0.076)	(0.274)
Constant	-6.115***	-1.470***	0.504	-0.112**	-1.554***	0.390
	(0.000)	(0.000)	(0.564)	(0.019)	(0.001)	(0.663)
Ind/Yr FE	Yes	Yes	Yes	Yes	Yes	Yes
Obs	14,406	12,139	1,491	13,854	8,539	1,631
Adj Rsq	0.257	0.796	0.805	0.053	0.799	0.828
F Statistic				*15.85*		

					2nd Stage	
		Full		PSM	2SLS Full	2SLS PSM
Panel B. Dependent Variable at Time (t+1)		Net CSR $_{t+1}$		Net CSR $_{t+1}$	Net CSR $_{t+1}$	
	(1)	(2)	(3)	(4)	(5)
Lawsuit Firm $_t$	0.225*	0.185**	0.190		
	(0.085)	(0.040)	(0.118)		
Instr Lawsuit Firm $_t$				2.917***	3.652**
				(0.002)	(0.043)
Lagged CSR Controls	No	Yes	Yes	Yes	Yes
Other Controls	Yes	Yes	No	Yes	Yes
Ind/Yr FE	Yes	Yes	Yes	Yes	Yes
Obs	13,693	11,520	1,447	8,193	1,593
Adj Rsq	0.257	0.638	0.688	0.638	0.723

Table 3
Responsive CSR as Damage Control

This table examines the impact of varying levels of financial statement indicators of risk in the year prior to the SCA filing on the relationship between SCA filings and ex-post net CSR score. Panel A splits the sample by firm-year in year (t-1) into groups based on three measures of financial statement risk: 1) the Financial Statement Divergence (FSD) score of Amiram, Bozanic, and Rouen (2015) split into high and low quantiles, 2) the manager-based internal control material weakness (ICMW) disclosure indicator variable based on section 302 of SOX of Hoitash, Hoitash, and Johnstone (2012), 3) the auditor-based ICMW disclosure indicator variable based on section 404 of SOX of Hoitash, Hoitash, and Johnstone (2012), 4) a strict filter classifying firm-years with weaknesses in all three prior categories as one, and zero for firm-years shown as not having a weakness for all three categories simultaneously, and 5) a relaxed filter classifying firms with weaknesses in any of the three categories as one, and zero if the firm-year was shown to not have a weakness in at least one category. Variable definitions are reported in Appendix A, and continuous variables are winsorized at the 1% and 99% level. Controls, industry, and year fixed effects are applied as specified, p-values are reported in parentheses, and robust standard errors are clustered by firm. *,**,*** represent significance at the 10%, 5%, and 1% level, respectively (‡ represents significance at the 15% level for the Wald statistic only).

Panel A. Impact of Financial Statement Weakness on CSR_{t+1}	Financial Statement Divergence	SOX 302 Manager Weakness	SOX 404 Auditor Weakness	Weakness All Categories	Weakness Any Category
	(1)	(2)	(3)	(4)	(5)
Low Weakness $_{t-1}$	0.302**	0.191**	0.227**	0.384**	0.339**
	(0.021)	(0.046)	(0.039)	(0.021)	(0.015)
High Weakness $_{t-1}$	0.044	0.018	0.034	-0.402	0.046
	(0.712)	(0.930)	(0.890)	(0.341)	(0.678)
Wald Statistic	2.37‡	0.64	0.60	4.23**	2.68‡
Controls	Yes	Yes	Yes	Yes	Yes
Ind/Yr FE	Yes	Yes	Yes	Yes	Yes

Table 4
Responsive CSR and the Legal Environment

This table examines the relationship between SCA filings and ex-post net CSR score after excluding firm-year observations in defendant friendly legal environments. Panel A examines the relationship between SCA filings and net CSR score for the full sample in year (t+1) after separately excluding measures representing defendant friendly environments using proxies as follows: 1) firms incorporated in states that have passed Universal Demand laws (Appel (2019)), 2) firms incorporated in states in the 9th Federal Circuit District (Crane and Koch (2016)), and 3) firms headquartered in the top 10 states ranked by the 2004 legal climate survey of the U.S. Chamber of Commerce Institute for Legal Reform. The Benchmark Coefficient is produced from the relationship between SCA filings and net CSR score in year (t+1) for the full sample without any exclusions. Panel B creates a "More Business Friendly" composite group of any firm-year observation represented by at least one of the exclusions of Panel A, versus a "Less Business Friendly" group composed of the remaining observations from the full sample. Variable definitions are reported in Appendix A, and continuous variables are winsorized at the 1% and 99% level. Controls, industry, and year fixed effects are applied, p-values are reported in parentheses, and robust standard errors are clustered by firm. *,**,*** represent significance at the 10%, 5%, and 1% level, respectively.

				Performance vs. Full Sample		
Panel A. Exclusions	Coeff	P-value	Obs	Bench Coeff	Pred	Actual
	(1)	(2)	(3)	(4)	(5)	(6)
Exclude UD Law States	0.213**	(0.033)	9,666	0.185**	+	+
Exclude 9th Circuit States	0.224**	(0.024)	8,924	0.185**	+	+
Exclude High ILR Rank	0.209**	(0.038)	10,234	0.185**	+	+

Panel B. Comparison of Less Business Friendly vs. More Business Friendly (Exclusion) Group	Coeff	P-value	Obs	Wald Statistic		
	(1)	(2)	(3)	(4)		
Less Business Friendly	0.278**	(0.024)	6,228			
				1.430		
More Business Friendly	0.068	(0.592)	5,292			

Table 5
Responsive CSR and the Corporate Environment

This table examines the relationship between SCA filings and ex-post net CSR score after excluding firm-year observations in corporate environments where institutional owners have less ability to employ "voice" to influence management. Panel A examines the exclusion of environments for weak monitoring using proxies as follows: 1) firms with a dual class share structure (Baran and Forst (2015)), 2) firms that have a classified (staggered) board structure in their charter (Gompers, Ishii, and Metrick (2003)), and 3) firms facing securities class action litigation that have an unaffiliated individual investor as the lead plaintiff (as opposed to a representative from an institutional owner). The Benchmark Coefficient is produced from the relationship between SCA filings and net CSR score in year (t+1) for the full sample without any exclusions. Panel B creates a "Weak Monitoring" composite group of any firm-year observation represented by at least one of the exclusions of Panel A, versus a "Strong Monitoring" group composed of the remaining observations from the full sample. Variable definitions are reported in Appendix A, and continuous variables are winsorized at the 1% and 99% level. Controls, industry, and year fixed effects are applied, p-values are reported in parentheses, and robust standard errors are clustered by firm. *,**,*** represent significance at the 10%, 5%, and 1% level, respectively.

				Performance vs. Full Sample		
Panel A. Exclusions	Coeff	P-value	Obs	Bench Coeff	Pred	Actual
	(1)	(2)	(3)	(4)	(5)	(6)
Exclude Dual Class Firms	0.187*	(0.057)	10,075	0.185**	+	+
Exclude Firms w/ Classified Boards	0.248**	(0.024)	9,518	0.185**	+	+
Exclude Indiv Lead Plaintiff Cases	0.183**	(0.047)	11,501	0.185**	+	-

Panel B. Comparison of Strong Monitoring vs. Weak Monitoring (Exclusion) Group	Coeff	P-value	Obs	Wald Statistic		
	(1)	(2)	(3)	(4)		
Strong Monitoring Group	0.255**	(0.036)	8,260			
				1.340		
Weak Monitoring Group	0.066	(0.559)	3,260			

Table 6
Responsive CSR and Institutional Investor Horizon – The Bushee Measure

This table examines the relationship between SCA filings and ex-post net CSR score given varying holding periods by the firm's institutional owners using the institutional investor classifications of Bushee (1998, 2001). Panel A utilizes the long-term ratio (Bushee (1998, 2001) as the dependent variable in a univariate OLS model in the three years before and after a lawsuit filing. Panel B splits the sample by firm-year into groups based on the percent of IO in dedicated or quasi-index funds and runs OLS and 2SLS regressions as specified. Variable definitions are reported in Appendix A, and continuous variables are winsorized at the 1% and 99% level. Controls, industry, and year fixed effects are applied as specified, p-values are reported in parentheses, and robust standard errors are clustered by firm. *,**,*** represent significance at the 10%, 5%, and 1% level, respectively.

Panel A. Dependent Variable at Time (t)	Long term Ratio$_{t-3}$ (1)	Long term Ratio$_{t-2}$ (2)	Long term Ratio$_{t-1}$ (3)	Long term Ratio$_t$ (4)	Long term Ratio$_{t+1}$ (5)	Long term Ratio$_{t+2}$ (6)	Long term Ratio$_{t+3}$ (7)
Lawsuit Firm $_t$	0.001	0.000	0.002	0.008*	0.014***	0.010**	0.004
	(0.935)	(0.990)	(0.624)	(0.096)	(0.001)	(0.017)	(0.315)
Controls	No	No	No	No	No	No	No
Industry/Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Obs	10,467	11,817	13,181	13,278	12,800	12,220	11,650
Adj Rsq	0.065	0.064	0.061	0.060	0.064	0.070	0.076

	OLS Full				2SLS Full	2SLS PSM
Panel B. Dependent Variable at Time (t)	Quartiles (1)	Quantiles (2)	Quartiles (3)	Quantiles (4)	Quantiles (5)	(6)
Short Term	0.102	0.186**	0.133	0.105	1.931**	2.754
	(0.410)	(0.023)	(0.193)	(0.210)	(0.035)	(0.125)
Long Term	0.528***	0.414***	0.339**	0.264***	2.471***	7.232***
	(0.000)	(0.000)	(0.012)	(0.004)	(0.010)	(0.000)
Wald Statistic	4.98**	3.59*	1.54	1.66	0.12	3.11*
Lagged CSR Controls	Yes	Yes	Yes	Yes	Yes	Yes
Other Controls	No	No	Yes	Yes	Yes	Yes
Ind/Yr FE	Yes	Yes	Yes	Yes	Yes	Yes

Table 7
Responsive CSR and Institutional Investor Horizon – The Churn Measure

This table examines the relationship between SCA filings and ex-post net CSR score given varying holding periods by the firm's institutional owners using the investor flow robust churn measure of Yan and Zhang (2009). Short Term, Mid Term, and Long Term represent terciles of high, moderate, and low investor churn (investor turnover), respectively. We create subsamples based on these terciles and run OLS and 2SLS regressions on each subsample as specified. Variable definitions are reported in Appendix A, and continuous variables are winsorized at the 1% and 99% level. Controls, industry, and year fixed effects are applied, p-values are reported in parentheses, and robust standard errors are clustered by firm. *,**,*** represent significance at the 10%, 5%, and 1% level, respectively.

Long Term, Mid Term, and Short Term IOs	OLS Full			2SLS 2nd Stage - Full		
	Short Term	Mid Term	Long Term	Short Term	Mid Term	Long Term
	(1)	(2)	(3)	(4)	(5)	(6)
Lawsuit Firm $_t$	0.195	0.237**	0.302**			
	(0.130)	(0.050)	(0.021)			
Instr Lawsuit Firm $_t$				1.640	2.539*	2.731*
				(0.167)	(0.072)	(0.066)
Ind/Yr FE	Yes	Yes	Yes	Yes	Yes	Yes
Obs	3,206	3,068	3,033	2,049	2,194	2,157
Adj Rsq	0.754	0.788	0.829	0.826	0.778	0.750

Table 8
Responsive CSR and Institutional Owner Size

This table examines the relationship between SCA filings and ex-post net CSR score given varying levels of institutional investment size. We proxy for investment size using 1) the total market capitalization of the investment firm, and 2) the total firm market capitalization multiplied by the percentage of institutional ownership in the firm. We split the sample by firm-year into a high group (top quartile) and a low group (bottom three quartiles) based on market cap (or by the interaction of market cap and IO) and run OLS and 2SLS regressions as specified. Variable definitions are reported in Appendix A, and continuous variables are winsorized at the 1% and 99% level. Controls, industry, and year fixed effects are applied, p-values are reported in parentheses, and robust standard errors are clustered by firm. *,**,*** represent significance at the 10%, 5%, and 1% level, respectively.

	OLS Full				2SLS Full			
	Investment Size		Investment Size x IO		Investment Size		Investment Size x IO	
Dependent Variable: Net CSR $_t$	Low	High	Low	High	Low	High	Low	High
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Lawsuit Firm $_t$	0.055	0.269***	0.050	0.367***				
	(0.394)	(0.007)	(0.473)	(0.001)				
Instr Lawsuit Firm $_t$					1.597***	3.371**	2.301***	2.735**
					(0.033)	(0.003)	(0.003)	(0.033)
Wald Statistic	3.11*		5.97**		0.32		0.08	
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Ind/Yr FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Obs	9,174	2,956	9,051	3,077	6,135	1,998	5,996	2,137
Adj Rsq	0.688	0.836	0.754	0.836	0.728	0.850	0.789	0.818

Table 9
Responsive CSR and the Interaction of Institutional Owner Horizon and Size

This table examines the interaction of institutional owner investment horizon and IO size on ex-post net CSR score. Panel A examines firms held by the top quantile of long-term IOs as defined by Bushee (1998, 2001), while panel B examines firms held by the top quantile of "grey" IOs (those with multiple firm relationships who are expected to have long horizons). Columns 1 and 2 examine firms with the presence of a blockholder, Columns 3 and 4 examine firms in the bottom four quintiles of IO concentration vs. the top quintile, and Columns 5 and 6 examine firms in the bottom four quintiles by the maximum percent held by any IO vs. the top quintile. Variable definitions are reported in Appendix A, and continuous variables are winsorized at the 1% and 99% level. Controls, industry, and year fixed effects are applied, p-values are reported in parentheses, and robust standard errors are clustered by firm. *,**,*** represent significance at the 10%, 5%, and 1% level, respectively.

Panel A.	Blockholder Pres		Concentration		Max % Held	
Long-Term IOs	No	Yes	Low	High	Low	High
	(1)	(2)	(3)	(4)	(5)	(6)
Lawsuit Firm $_t$	-0.057	0.294***	0.258**	0.343*	0.251**	0.349*
	(0.891)	(0.008)	(0.010)	(0.075)	(0.012)	(0.058)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Ind/Yr FE	Yes	Yes	Yes	Yes	Yes	Yes
Obs	389	4,483	4,782	1,282	5,006	1,058
Adj Rsq	0.876	0.814	0.828	0.703	0.826	0.754

Panel B.	Blockholder Pres		Concentration		Max % Held	
Grey IOs	No	Yes	Low	High	Low	High
	(1)	(2)	(3)	(4)	(5)	(6)
Lawsuit Firm $_t$	-0.060	0.261**	0.205**	0.229*	0.182*	0.464**
	(0.844)	(0.015)	(0.041)	(0.099)	(0.059)	(0.038)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Ind/Yr FE	Yes	Yes	Yes	Yes	Yes	Yes
Obs	468	4,384	4,814	1,267	4,938	1,143
Adj Rsq	0.869	0.803	0.818	0.675	0.819	0.710