



Shareholder litigation rights and ESG controversies: A quasi-natural experiment

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ABSTRACT

Leveraging as a quasi-natural experiment the staggered passage of universal demand laws, which raise the difficulty of shareholder lawsuits, we examine the effect of shareholder litigation rights on ESG controversies. Our difference-in-differences estimates show that an exogenous decline in shareholder litigation risk results in a significant drop in ESG controversies. Specifically, ESG controversies fall by 40.85% in response to an exogenous reduction in litigation risk. When more insulated from shareholder litigation, managers prefer to live a quiet life, intentionally avoiding risky and contentious activities, which require more managerial time and effort. Additional analysis validates the results, including propensity score matching, entropy balancing, and Oster's (2019) testing of coefficient stability. Finally, we find that ESG controversies erode firm profitability considerably, consistent with the theoretical expectations.

1. Introduction

Exploiting as an exogenous shock the staggered passage of state legislations that weaken shareholder litigation rights, we examine the influence of shareholder litigation risk on ESG controversies. While there is a wealth of research on CSR/ESG performance, ESG controversies have drawn significantly less attention. ESG controversies should be explored more often, since they have been demonstrated to severely impair corporate value (Frooman, 1997; Klassen & McLaughlin, 1996; Treepongkaruna, Kyaw, & Jiraporn, 2021a; Treepongkaruna, Kyaw, & Jiraporn, 2021b). Investors have borne a substantial share of the cost of ESG-related controversies. According to a study conducted by Bank of America Merrill Lynch, major ESG-related scandals slashed the value of leading US firms in the S&P 500 by USD 534 billion between 2014 and 2019. (Luo, 2021).³ Thus, it is hard to overestimate the significance of ESG controversies (Treepongkaruna et al., 2021a; Treepongkaruna

et al., 2021b).

Prior research has carefully examined different internal and external governance mechanisms. The risk of shareholder litigation is one of the most distinctive external governance mechanisms. Because the threat of shareholder lawsuits deters opportunistic managers from exploiting shareholders, shareholder litigation risk functions as a form of governance. When managers encounter possible legal consequences, they are dissuaded from taking advantage of shareholders, hence minimizing agency conflicts (Chatjuthamard & Jiraporn, 2021). In the domains of law, economics, finance, and accounting, there is a considerable body of literature on shareholder litigation risk (Alexander, 1991; Appel, 2015; Chatjuthamard & Jiraporn, 2021; Chu, 2017; Coffee, 1986; Deng, Willis, & Xu, 2014; Fields, 1990; Graham, Li, & Qiu, 2008; Johnson, Kasznik, & Nelson, 2000; Karpoff, Scott Lee, & Martin, 2008; Klein & Leffler, 1981). This is unequivocally a critical area of the literature.

Based on the literature, we advance two competing hypotheses to

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³ ESG scandals include a broad spectrum of concerns, ranging from monopolistic behavior and accounting fraud to workplace harassment and environmental disasters. These controversies have the potential to inflict a significant financial cost on firms, ranging from consumer boycotts to legal punishments. Further, the scandals would harm the images of the businesses and shareholders (Luo, 2021; Treepongkaruna et al., 2021a).

explain the effect of shareholder litigation rights on ESG controversies. First, we propose the trade-off hypothesis. According to this view, a reduction in shareholder litigation risk leads to an increase in ESG controversies. This theory may be viewed as managers carefully balancing various sources of risk that they confront. Managers are ready to accept a certain level of overall risk. When the threat of shareholder lawsuit falls, managers are willing to embrace more risk in the form of greater involvement in ESG controversies. They prudently trade off the risk in one area for another while remaining tolerant of the same total level of risk. According to this argument, an exogenous reduction in shareholder litigation rights brings about more ESG controversies.

On the contrary, the opposite view is that, when subject to less external pressures, managers tend to live a “quiet life”, deliberately avoiding risky and complicated activities that involve more managerial time and effort (Bertrand & Mullainathan, 2003). As controversial activities are more risky and probably require more executive time and effort to manage them, they are less likely to be taken when managers are more insulated from external pressures. This hypothesis therefore predicts a drop in ESG activities when shareholder litigation risk is reduced.

Taking advantage of the staggered implementation of universal demand laws, which make shareholder lawsuits more difficult, our difference-in-differences estimates show that an exogenous reduction in shareholder litigation rights results in significantly fewer ESG controversies. Our results corroborate the quiet life hypothesis. Managers avoid ESG controversies to a greater extent when more protected from shareholder lawsuits. In terms of economic significance, an exogenous reduction in shareholder litigation risk associated with the adoption of universal demand laws lowers ESG controversies by 40.85%. Therefore, not only is the effect of litigation risk statistically significant, it is also economically palpable. Because our identification strategy is based on an exogenous shock at the state level, our findings probably reflect a causal influence, rather than merely an association.

While our empirical strategy is already less vulnerable to endogeneity, we still perform several robustness checks, i.e., propensity score matching, entropy balancing, using Oster's (2019) technique for testing coefficient stability, and testing the difference in ESG controversies before the passage of universal demand laws. All the robustness checks firmly validate our conclusion. Finally, we examine the impact of ESG controversies on corporate profitability. Theories, such as the legitimacy theory, the stakeholder theory, and agency theory, all suggest that ESG controversies should have an adverse impact on firm performance. Consistent with the theoretical expectations, we find that ESG controversies depress profitability considerably.

Our study provides significant contributions to several major areas of the literature. First, there is a wealth of studies on corporate CSR/ESG performance. However, there is a scarcity of research on ESG controversies. This study fills a significant gap in the literature. For the first time, we investigate how shareholder litigation rights impact ESG controversies. We find that universal demand laws, which weaken shareholder litigation rights substantially, reduce corporate controversial activities. Crucially, legislators should keep in mind that a given law or regulation may impact the extent to which firms are involved in ESG controversies. Second, our research adds to the body of knowledge in corporate governance. Prior research has extensively examined the effects of internal governance mechanisms, such as board characteristics (Hauser, 2018; Masulis & Zhang, 2019; Rosenstein & Wyatt, 1990; Yermack, 1996), as well as external governance mechanisms, such as the takeover market (Yermack, 1996; Rosenstein & Wyatt, 1990; Hauser, 2018; Masulis and Zhang (Manne, 1965; Fama & Jensen, 1983; Fama, 1980; Lel & Miller, 2015; Cain, McKeon, & Solomon, 2017; Ongsakul, Chatjuthamard, Jiraporn, & Jiraporn, 2021; Ongsakul, Chatjuthamard, Jiraporn, & Chaivisuttangkun, 2021; Chatjuthamard, Ongsakul, & Jiraporn, 2022). We contribute to the literature on corporate governance by examining one of the most unique external governance instruments, shareholder litigation rights. We demonstrate that an exogenous

reduction in litigation risk significantly reduces ESG controversies. Shareholders, shareholder activists, and investors in general, who focus on the role of corporate governance, are informed by our research that shareholder litigation rights constitute an important external governance mechanism.

Moreover, we make a significant contribution to an area of the literature that focuses on the quiet life hypothesis (Asongu & Odhiambo, 2018; Berger & Hannan, 1998; Bertrand & Mullainathan, 2003; Chintakarn, Jiraporn, & Jiraporn, 2013; Coccoresse & Pellicchia, 2010; Gormley, Gupta, & Jha, 2018; Guo, Chan, & Huang, 2018; Koetter, Kolari, & Spierdijk, 2012; Shi, Hoskisson, & Zhang, 2016). This hypothesis has been previously investigated in the literature. Yet, our paper is the first to examine the quiet life hypothesis in the context of corporate controversial activities. We demonstrate that, in terms of ESG controversies, the evidence supports the quiet life hypothesis.

Furthermore, our research adds to a rapidly expanding body of research examining the effects of staggered UD law adoption on a variety of corporate outcomes, including the information environment (Boone, Fich, & Griffin, 2018), corporate takeover efficiency (Chu & Zhao, 2021), corporate innovation (Lin, Liu, & Manso, 2020), cost of debt (Ni & Yin, 2018), corporate disclosure (Bourveau, Lou, & Wang, 2018), corporate cash holdings (Nguyen, Phan, & Sun, 2018), corporate complexity (Chatjuthamard & Jiraporn, 2021), and corporate governance efficiency, policies, and practices (Appel, 2015; Bourveau et al., 2018). We enrich the research in this area by demonstrating that when shareholder litigation rights are restricted, ESG controversies are markedly reduced.

2. Background information, pertinent research, and hypothesis development

2.1. Shareholder litigation and universal demand laws

A shareholder derivative lawsuit is a legal action brought on behalf of the corporation by individual shareholders against its executives and directors for alleged misconduct that is detrimental to the corporation as a whole. This is a derivative litigation because the wrongdoing first hurts the business and then erodes the welfare of all shareholders. Thus, stockholders who bring derivative litigation do so on behalf of the business rather than on their own behalf (Chatjuthamard & Jiraporn, 2021; Lin et al., 2020). Shareholders must make a demand on the corporation's board of directors before bringing a derivative action. However, because derivative proceedings commonly include directors, it is highly probable that the lawsuit demand will be rejected. To prevent directors from unlawfully impeding a derivative action, courts established the futility exception, which allows the plaintiff shareholder to circumvent the demand requirement by arguing that the board member who committed the breach is incapable of rendering an impartial decision (Chatjuthamard & Jiraporn, 2021; Lin et al., 2020).

However, between 1989 and 2005, 23 states in the United States enacted universal demand (UD) legislation, mandating shareholders to make a demand on the board of directors before filing a lawsuit. Following the passage of the UD law, shareholders lost the ability to claim demand futility. As a result, the passing of the UD law raises the procedural difficulties for bringing derivative lawsuits (Appel, 2015; Chen, Li, and Xu, 2019; Lin et al., 2020; Chatjuthamard & Jiraporn, 2021).

According to the literature in law and finance, shareholder lawsuits are meant to protect the interests of minority shareholders (e.g., La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1998; Lin et al., 2020). Managers and directors have a fiduciary duty to operate in the best interests of shareholders in order to meet their legal commitments. Shareholders may sue for misconduct if managers enhance their own interests at the expense of shareholders. If CEOs and directors breach their fiduciary duties, they can be held personally accountable in court. Previous research has found that shareholder-management conflict is

reduced by liability laws and private enforcement (La Porta et al. 1998; Lin et al., 2020). As a result, shareholder litigation rights serve as an important external governance mechanism (Chatjuthamard & Jiraporn, 2021).

2.2. Using the passage of universal demand laws as an exogenous shock

Lin et al. (2020) conduct a series of empirical tests to demonstrate that the staggered implementation of universal demand laws results in significant exogenous changes in shareholder litigation rights. They show that, when the laws are passed, there is a large drop in derivative cases, which is consistent with the assumption. Furthermore, there has been no commensurate increase in class action litigation to compensate for the decrease in derivative lawsuits. Finally, there is little evidence that firms change their state of incorporation to take advantage of the weaker litigation rights in particular states. Lin et al. (2020) provide strong support for this identification technique being both theoretically adequate and empirically effective.

Several recent studies have used this empirical technique to examine the influence of shareholder litigation rights on a variety of corporate outcomes and policies. For example, Ni and Yin (2018) demonstrate that weaker litigation rights considerably increase the cost of debt, implying that shareholder litigation rights matter to debtholders. According to Obaydin, Zurbruegg, Hossain, Adhikari, and Elnahas (2021), an exogenous drop in litigation risk lessens the chance of stock crash risk. Nguyen, Phan, and Lee (2020) see a considerable rise in leverage following the adoption of universal demand laws, with the effect being most obvious for companies subject to litigation risk and financial constraints. According to Nguyen et al. (2018), the enactment of universal demand laws results in a decrease in corporate cash reserves but a rise in the value of cash holdings.

Furthermore, Do (2021) shows a large increase in dividend distributions following the enactment of universal demand laws, with the effect being stronger for companies with greater financial constraints and greater institutional shareholdings. Accounting conservatism is seen to rise in reaction to a reduction in shareholder litigation rights, according to Manchiraju, Pandey, and Subramanyam (2020). Lin et al. (2020) find that when the laws were adopted, firms increased their investment in R&D, created more patents in new technical classes and patents based on new knowledge, produced more inventions with significant impacts, and gained higher patent value. According to their findings, management is discouraged from engaging in exploratory innovation projects due to the external pressure caused by shareholder litigation. Boone et al. (2018), Appel (2015), Bourveau et al. (2018), Chu and Zhao (2021), Le, Nguyen, and Sila (2021), and Huang, Li, Yu, and Zhou (2020), and Chatjuthamard and Jiraporn (2021) are other recent studies that exploit a similar identification technique.

2.3. ESG controversies

At least three theories are relevant to ESG controversies, according to the literature: the legitimacy theory, the stakeholder theory, and agency theory (Treepongkaruna et al., 2021a). To begin, according to the legitimacy theory, ESG controversies are critical. Corporate legitimacy is crucial for a business's long-term existence. According to Suchman (1995), legitimacy refers to a generally held belief or assumption that an entity's actions are desirable, acceptable, or appropriate within a socially constructed system of norms, values, beliefs, and definitions (Aouadi & Marsat, 2016; Treepongkaruna et al., 2021a; Treepongkaruna et al., 2021b). When businesses become embroiled in contentious activities, their legitimacy is questioned, and their organizational legitimacy is brought into doubt (Aouadi & Marsat, 2016; Palazzo & Scherer, 2006; Treepongkaruna et al., 2021a). Accusations of dubious activities have a damaging effect on the brand and reputation of a business (Aouadi & Marsat, 2016; Donaldson & Preston, 1995; Treepongkaruna et al., 2021a; Treepongkaruna et al., 2021b).

Furthermore, according to the stakeholder theory, socially responsible behaviors boost a company's value by promoting positive connections with stakeholders (Aouadi & Marsat, 2016; Donaldson & Preston, 1995; Godfrey, Merrill, & Hansen, 2009; Kacperczyk, 2009; Treepongkaruna et al., 2021a; Treepongkaruna et al., 2021b). Controversial operations, on the other hand, aggravate stakeholder skepticism and perceptions of corporate deception (Aouadi & Marsat, 2016; Du, Bhattacharya, & Sen, 2010; Maignan & Ralston, 2002), resulting in lower credibility (Godfrey et al., 2009; Aouadi & Marsat, 2016; Treepongkaruna et al., 2021a; Treepongkaruna et al., 2021b).

Finally, agency theory argues that managers acting as representatives for shareholders may not always behave in their best interests due to agency conflicts (Jensen & Meckling, 1976). When managers' incentives do not line up with those of shareholders, agency problems emerge. It is possible that self-interested managers would have the company participate in contentious activities in order to increase their own gains at the expense of shareholders. However, corporate governance serves to reduce agency conflicts and better match the interests of shareholders and management (Treepongkaruna et al., 2021a, 2021b). Previous research has employed agency theory to investigate the influence of corporate governance on ESG/CSR performance (Chintrakarn, Jiraporn, Kim, & Kim, 2016; Chintrakarn, Jiraporn, Tong, Jiraporn, & Proctor, 2020; Jain & Jamali, 2016; Jo & Harjoto, 2012; Treepongkaruna et al., 2021a; Treepongkaruna et al., 2021b).

While the literature is replete with studies on socially responsible behavior, there is a paucity of studies on ESG scandals. Controversies over environmental, social, and governance issues are predicted to have a corrosive influence on corporate value (Aouadi & Marsat, 2016; Fombrun & Shanley, 1990; Orlitzky, 2013; Treepongkaruna et al., 2021a; Treepongkaruna et al., 2021b; Weigelt & Camerer, 1988). According to Frooman (1997), when a firm participates in socially irresponsible or questionable social behavior, the stock market reacts negatively. Similarly, Klassen and McLaughlin (1996) find that unfavorable environmental, social, and governance (ESG) news items result in negative market returns (Aouadi & Marsat, 2016; Treepongkaruna et al., 2021a; Treepongkaruna et al., 2021b).

2.4. The trade-off hypothesis

This view argues that a decline in shareholder litigation risk brings about more ESG controversies. This hypothesis can be seen as managers carefully trading off different sources of risk that they face. There is a certain amount of total risk that managers are willing to accept. When there is a drop in shareholder litigation risk, managers are ready to accept higher risk in the form of more engagement in ESG controversies. They cautiously trade off the risk in one area for another while still being tolerant of the same amount of risk overall. This view thus predicts that an exogenous reduction in shareholder litigation rights results in more ESG controversies.

2.5. The quiet life hypothesis

This hypothesis assumes that, when subject to less litigation risk, managers prefer to live a "quiet life". This view is motivated by the quiet life hypothesis, which argues that, when insulated from external pressures, risk-averse managers tend to deliberately avoid risky and complex investments that require more managerial time and effort (Bertrand & Mullainathan, 2003). Unlike typical shareholders with diversified portfolios, managers are more exposed to firm-specific risk due to their human capital that is specific to the firm. Therefore, they tend to be more risk averse and be in favor of less risky corporate policies and strategies (Amihud & Lev, 1981; Smith & Stulz, 1985). When shielded from external pressures, managers can better adopt corporate policies that suit their own self-interested risk preferences. Because controversial activities are riskier, managers who prefer a quiet life are less inclined to be involved in such risky and contentious actions as they tend to demand

more executive time and effort. This view therefore predicts that an exogenous drop in shareholder litigation rights brings about fewer ESG controversies.

3. Sample construction, data description, and empirical strategy

3.1. Sample selection

Refinitiv provides the data on ESG controversies. COMPUSTAT supplies the data on firm-specific characteristics. Outliers are winsorized at the 1% and 99% levels as necessary. The resulting sample is an unbalanced panel data set of 7901 firm-year observations spanning the years 2002 to 2016.⁴ The ESG controversies score is based on 23 ESG controversial issues, with recent controversies represented in the most recent complete period. Within each industry segment, a percentile rank algorithm is used. As a result, the score shows the extent to which a given business engages in ESG controversies in comparison to its industry counterparts. A higher value of the ESG controversies score indicates fewer ESG controversies. Refinitiv provides more specific information regarding the construction of the ESG controversies score.

3.2. Empirical strategy

Essentially, we estimate the following difference-in-differences regression analysis:

$$ESG\ Controversies\ Score_{it} = \alpha + \beta_1(UDL)_{it} + \beta_2(Controls)_{it}$$

where the ESG controversies score is provided by Refinitiv. UDL is a binary variable for a firm incorporated in a state where a universal demand law has been implemented in a given year, and zero otherwise.⁵ This approach has been widely adopted in the recent literature (Lin et al., 2020).

Consistent with the literature in this area, we include several control variables that may influence ESG controversies (Treepongkaruna et al., 2021a; Treepongkaruna et al., 2021b). Specifically, we include firm size (Ln of total assets), profitability (EBIT/total assets), leverage (total debt/total assets), capital investments (capital expenditures/total assets), intangible assets (R&D/total assets and advertising expense/total assets), discretionary spending (SG&A expense/total assets), cash holdings (cash holdings/total assets), dividend payouts (dividends/total assets), and asset tangibility (fixed assets/total assets). Notably, we also include the ESG score to account for the extent to which the company engages in ESG-related activities. Companies that engage in more socially responsible activities may be more reluctant to get tangled up in ESG controversies. Crucially, we include firm fixed effects to account for any time-invariant firm attributes, which helps mitigate the omitted-variable bias. Moreover, we include year fixed effects to account for any variation over time. The variable definitions are shown in the Appendix at the end of this paper. Table 1 displays the summary statistics for the variables.

4. Results

4.1. Baseline analysis

Table 2 displays the difference-in-differences regression results,

⁴ Our sample starts in 2002 because the data for ESG controversies are available starting in 2002. Our sample ends in 2016 because the latest passage of universal demand laws was before 2010. So, by 2016, a sufficient amount of time has passed to see the effect. Stretching the sample period beyond 2016 would include those years that are too far from the last passage of universal demand laws and may confound the analysis.

⁵ Rather than using the state of incorporation in COMPUSTAT, which is the current state of incorporation, we employ historical state of incorporation provided by Bill McDonald. Our sincere thanks go to Bill McDonald for sharing the data.

where the dependent variable is the ESG controversies score. Firm and year fixed effects are included, and the standard errors are clustered by firm. We do not include any control variables in Model 1 as some of the control variables might be endogenous. The result might be biased to the extent that endogenous variables are included (Gormley & Matsa, 2016). The coefficient of UDL is positive and significant in Model 1. In Model 2, we add the control variables. Again, UDL still exhibits a positive and significant coefficient. The findings suggest that an exogenous reduction in shareholder litigation rights reduces ESG controversies significantly, supporting the quiet life hypothesis. Managers engage in less risky behavior when they are more insulated from outside pressures because they would rather live a quiet life. Moreover, when more protected from shareholder litigation, they tend to concentrate on long-term profitability and are less inclined to engage in controversial activities.

As far as economic significance, we estimate the economic magnitude of the effect as follows. The coefficient of UDL in Model 2 is 11.76, implying that the implementation of universal demand laws raises the ESG controversies score by 11.76 (the higher the score, the fewer ESG controversies). The standard deviation of the ESG controversies score is 28.76. Therefore, an exogenous drop in shareholder litigation risk lowers ESG controversies by 11.76 divided by 28.76, which is 40.85%. Not only is the effect of the reduction in litigation risk statistically significant, it is also economically non-trivial. Notably, because our empirical strategy is based on the staggered passage of universal demand laws across different states, our results are considerably less susceptible to endogeneity and should reflect a causal influence, rather than a mere correlation.

4.2. Propensity score matching (PSM)

We validate the findings through the use of propensity score matching (Lennox, Francis, & Wang, 2011; Rosenbaum & Rubin, 1983). The treatment group is comprised of observations incorporated in the states governed by universal demand laws. Then, for each observation in the treatment group, we choose the most comparable observation from the remainder of the sample based on ten firm characteristics (i.e., using the ten control variables included in the regression analysis). With the exception of shareholder litigation rights, our treatment and control firms are basically nearly identical in every observable aspect.

We conduct diagnostic testing to confirm the appropriateness of our matching. The findings are summarized in Table 3 Panel A. Model 1 is a logistic regression with a binary dependent variable equal to one if the firm is included in the treatment group and zero otherwise. Model 1 includes the whole sample (pre-match). The coefficient of the ratio of cash holdings is significantly negative, suggesting that the treatment firms hold significantly less cash. It is important to account for this significant difference to ensure that our conclusion is not biased.

Model 2 is a logistic regression for the sample with propensity score matching (post-match). None of the coefficients in Model 2 are significant. As a result, our treatment and control firms are statistically equal in all quantifiable aspects. To the extent that shareholder litigation rights are unimportant, our treatment and control firms should also be equal in terms of ESG controversies. Table 3 Panel B contains the regression findings for the propensity-score matched sample. The coefficients of UDL remain significantly positive, once again confirming the quiet life hypothesis. Due to the consistency of our PSM results, our conclusion does not appear to be primarily driven by endogeneity.

4.3. Entropy balancing

Previous research has put a great emphasis on the idea of observable selection. To avoid this assumption, we employ Hainmueller (2012) entropy balancing approach, a variant on standard matching algorithms. Entropy balancing, in particular, provides a high degree of covariate balance by explicitly adding covariate balance in the weight function

Table 1
Descriptive statistics.

	Mean	S.D.	25th	Median	75th
ESG Metrics					
ESG Controversies Score	83.546	28.786	77.500	100.000	100.000
ESG score	39.387	19.505	24.010	35.880	52.960
Universal Demand Laws					
Universal Demand Laws (UDL)	0.129	0.335	0.000	0.000	0.000
Firm Characteristics					
Total Assets	16,568.660	41,444.750	2770.027	5849.251	15,000.000
Total Debt/Total Assets	0.261	0.193	0.131	0.243	0.360
Capital Expenditures/Total Assets	0.051	0.053	0.020	0.037	0.063
R&D Expense/Total Assets	0.026	0.052	0.000	0.000	0.029
Advertising Expense/Total Assets	0.013	0.034	0.000	0.000	0.011
Dividends/Total Assets	0.019	0.046	0.000	0.010	0.025
Cash Holdings/Total Assets	0.139	0.145	0.033	0.089	0.195
SG&A Expense/Total Assets	0.190	0.179	0.055	0.146	0.276
Board Attributes					
% Independent Directors	78.844	12.105	72.727	81.818	88.889
Board Size	10.105	2.092	9.000	10.000	11.000

The ESG controversies score is based on 23 ESG controversies issues, with recent controversies represented in the most recent complete period. Within each industry segment, a percentile rank algorithm is used. As a result, the score shows the extent to which a given business engages in ESG controversies in comparison to its industry counterparts. Refinitiv provides more specific information regarding the construction of the ESG controversies score. Universal Demand Laws (UDL) is a binary variable for a firm incorporated in a state where a universal demand law has been implemented in a given year, and zero otherwise. SG&A Expense is selling, general, and administrative expense.

Table 2
The effect of shareholder litigation rights on ESG controversies.

	(1)	(2)
	ESG Controversies	ESG Controversies
Universal Demand Laws (UDL)	12.101*** (2.765)	11.764*** (2.831)
Firm Size		-1.906 (-1.365)
Leverage		-1.284 (-0.365)
Profitability		16.159*** (4.516)
Capital Investments		9.030 (0.801)
R&D Intensity		19.317 (1.233)
Advertising Intensity		-57.542 (-1.451)
Dividend Payouts		-21.117** (-2.071)
Cash Holdings		2.311 (0.431)
Discretionary Spending		-10.112 (-1.003)
ESG score		-0.149*** (-3.393)
Constant	81.986*** (145.202)	105.135*** (7.873)
Firm Fixed Effects	Yes	Yes
Year Fixed Effects	Yes	Yes
Observations	7883	7883
Adjusted R-squared	0.333	0.338
Robust t-statistics in parentheses		
*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$		

The ESG controversies score is based on 23 ESG controversies issues, with recent controversies represented in the most recent complete period. Within each industry segment, a percentile rank algorithm is used. As a result, the score shows the extent to which a given business engages in ESG controversies in comparison to its industry counterparts. Refinitiv provides more specific information regarding the construction of the ESG controversies score. Universal Demand Laws (UDL) is a binary variable for a firm incorporated in a state where a universal demand law has been implemented in a given year, and zero otherwise. SG&A Expense is selling, general, and administrative expense.

applied to sample units (Hainmueller, 2012; Balima, 2020). Hainmueller (2012) discusses entropy balancing in much greater depth. Recent research has made extensive use of this novel matching approach (Bol, Giani, Blais, & Loewen, 2020; Chatjuthamard & Jiraporn, 2021; Freier, Schumann, & Siedler, 2015; Glendening, Mauldin, & Shaw, 2019; Marcus, 2013; McMullin & Schonberger, 2020; Neuenkirch & Neumeier, 2016; Neuenkirch & Tillmann, 2016; Ongsakul et al., 2021; Truex, 2014; Wilde, 2017).

Table 4 summarizes the regression results following entropy balancing. The coefficient of UDL stays positive and statistically significant. An exogenous reduction in shareholder litigation rights results in a considerable decline in ESG controversies, validating the quiet life hypothesis once again. Managers are hesitant to become entangled in controversies that take significant managerial time and effort when they are less subject to shareholder litigation risk.

4.4. Oster (2019) approach for testing coefficient stability

Further, to verify that our findings are not distorted by the omitted-variable bias, we leverage Oster's (2019) insight and estimate the magnitude of the influence of the unobservables necessary to overcome the effect of the observables, thereby reducing the validity of our conclusions (Chintrakarn et al., 2020). By using Oster's (2019) approach on our regressions in Table 2, we estimate that the unobservables' effect must be >1.31–2.41 times that of the observables in order to invalidate our results. In the literature, a ratio larger than one typically indicates that the results are robust. As a result, our findings do not appear to be affected by the omitted-variable bias.

4.5. Difference in ESG controversies before an exogenous shock

Our identification strategy depends critically on the parallel trend assumption, i.e., the treatment group would have followed a similar trend in the absence of an exogenous shock. This assumption cannot be directly tested as it is not possible to determine the counter-factual, i.e., how the treatment firms would have behaved without the passage of universal demand laws. In any event, we can look at the parallel trend assumption before the arrival of an exogenous shock. To the extent that there is no difference in the treatment and control firms in terms of ESG controversies, our empirical strategy should be, more likely than not, acceptable.

First, we look at the period before the passage of universal demand

Table 3
Propensity score matching.

Panel A: Diagnostic testing		
	(1)	(2)
	Pre-Match Treatment Universal Demand Laws	Post-Match Treatment Universal Demand Laws
Firm Size	-0.116 (-1.048)	0.113 (0.928)
Leverage	-0.075 (-0.139)	-0.256 (-0.442)
Profitability	-0.193 (-0.270)	0.758 (0.716)
Capital Investments	-1.405 (-0.763)	1.002 (0.417)
R&D Intensity	-6.050 (-1.242)	-2.441 (-0.822)
Advertising Intensity	-0.898 (-0.264)	0.567 (0.128)
Dividend Payouts	0.967 (0.909)	1.763 (0.618)
Cash Holdings	-2.313** (-2.238)	0.857 (0.866)
Discretionary Spending	0.028 (0.036)	0.182 (0.230)
ESG score	0.006 (1.074)	-0.003 (-0.547)
Constant	-0.620 (-0.639)	-1.044 (-0.945)
Pseudo R-squared	0.024	0.006
Observations	7901	2034
Robust z-statistics in parentheses		
*** p < 0.01, ** p < 0.05, * p < 0.1		

Panel B: The effect of shareholder litigation rights on ESG controversies

	(1)	(2)
	ESG Controversies	ESG Controversies
Universal Demand Laws (UDL)	28.375** (2.584)	27.978** (2.557)
Firm Size		-2.232 (-0.696)
Leverage		-7.716 (-1.038)
Profitability		12.904 (1.047)
Capital Investments		-43.947 (-0.894)
R&D Intensity		-22.453 (-0.711)
Advertising Intensity		88.574 (1.040)
Dividend Payouts		-35.087 (-0.971)
Cash Holdings		-4.893 (-0.367)
Discretionary Spending		-14.559 (-0.694)
ESG score		-0.129 (-1.428)
Constant	68.638*** (11.205)	99.885*** (3.208)
Firm Fixed Effects	Yes	Yes
Year Fixed Effects	Yes	Yes
Observations	1823	1823
Adjusted R-squared	0.337	0.337
Robust t-statistics in parentheses		
*** p < 0.01, ** p < 0.05, * p < 0.1		

The ESG controversies score is based on 23 ESG controversies issues, with recent controversies represented in the most recent complete period. Within each industry segment, a percentile rank algorithm is used. As a result, the score shows the extent to which a given business engages in ESG controversies in comparison to its industry counterparts. Refinitiv provides more specific information regarding the construction of the ESG controversies score. Universal Demand

Laws (UDL) is a binary variable for a firm incorporated in a state where a universal demand law has been implemented in a given year, and zero otherwise. SG&A Expense is selling, general, and administrative expense.

Table 4
Entropy balancing.

	(1)	(2)
	ESG Controversies	ESG Controversies
Universal Demand Laws (UDL)	21.800*** (2.654)	21.783*** (2.770)
Firm Size		-2.182 (-0.952)
Leverage		-5.737 (-1.348)
Profitability		22.746** (2.490)
Capital Investments		-36.715 (-1.145)
R&D Intensity		-5.841 (-0.143)
Advertising Intensity		19.251 (0.290)
Dividend Payouts		-33.532 (-1.416)
Cash Holdings		-2.144 (-0.256)
Discretionary Spending		-15.566 (-1.045)
ESG score		-0.183*** (-3.052)
Constant	73.745*** (17.941)	105.046*** (4.721)
Firm Fixed Effects	Yes	Yes
Year Fixed Effects	Yes	Yes
Observations	7883	7883
Adjusted R-squared	0.296	0.302
Robust t-statistics in parentheses		
*** p < 0.01, ** p < 0.05, * p < 0.1		

The ESG controversies score is based on 23 ESG controversies issues, with recent controversies represented in the most recent complete period. Within each industry segment, a percentile rank algorithm is used. As a result, the score shows the extent to which a given business engages in ESG controversies in comparison to its industry counterparts. Refinitiv provides more specific information regarding the construction of the ESG controversies score. Universal Demand Laws (UDL) is a binary variable for a firm incorporated in a state where a universal demand law has been implemented in a given year, and zero otherwise. SG&A Expense is selling, general, and administrative expense.

laws and explore whether there is a significant difference in terms of ESG controversies between those firms incorporated in the states that eventually adopt universal demand laws and those that do not. To the extent that there is no difference before the enactment of universal demand laws, any difference found later can likely attributed to the exogenous shock.

Table 5 displays the regression results, where the dependent variable is the ESG controversies score. The variable “UDL State” is equal to one if the firm is located in the states that subsequently adopt universal demand laws, and zero otherwise. We include only the period before the passage of universal demand laws. The coefficient of UDL state is not significant, indicating that there is no difference in ESG controversies before the implementation of universal demand laws. Therefore, the difference in ESG controversies documented after the passage of universal demand laws can probably be ascribed to the exogenous shock, making it more likely to be a causal influence, not merely an association.

In addition, we run a placebo test where we concentrate on the year right before the passage of universal demand laws. We create a binary variable equal to one for the year immediately before the adoption of universal demand laws, and zero otherwise. The regression result is shown in Table 6. The coefficient of this variable is not significant, suggesting that there is no difference in ESG controversies right before

Table 5
Difference in ESG controversies between the states that that subsequently adopt UDL and those that do not.

	(1) ESG Controversies
UDL State	1.005 (0.851)
Firm Size	-8.062*** (-11.486)
Leverage	0.260 (0.093)
Profitability	14.851*** (3.574)
Capital Investments	-1.521 (-0.188)
R&D Intensity	10.729 (0.998)
Advertising Intensity	-36.314 (-1.214)
Dividend Payouts	-25.115** (-2.302)
Cash Holdings	-18.141*** (-4.436)
Discretionary Spending	-16.556*** (-3.443)
ESG score	-0.199*** (-5.353)
Constant	166.377*** (26.888)
Year Fixed Effects	Yes
Observations	6870
Adjusted R-squared	0.184
Robust t-statistics in parentheses	
*** p < 0.01, ** p < 0.05, * p < 0.1	

The ESG controversies score is based on 23 ESG controversies issues, with recent controversies represented in the most recent complete period. Within each industry segment, a percentile rank algorithm is used. As a result, the score shows the extent to which a given business engages in ESG controversies in comparison to its industry counterparts. Refinitiv provides more specific information regarding the construction of the ESG controversies score. Universal Demand Laws (UDL) is a binary variable for a firm incorporated in a state where a universal demand law has been implemented in a given year, and zero otherwise. SG&A Expense is selling, general, and administrative expense. UDL State is equal to one if the firm is located in state that subsequently adopt universal demand laws, and zero otherwise.

the implementation of universal demand laws. The results of the tests above imply that our identification strategy is probably valid.

4.6. Controlling for internal governance

Because shareholder litigation rights function as an instrument of external governance, it may be suggested that our analysis should control for internal governance. As the board of directors constitutes the ultimate internal governance mechanism, we control for board characteristics. Board size and board independence are the two most important attributes that have been frequently investigated in the literature and have been used as proxies for board quality (Cotter, Shivdasani, & Zenner, 1997; Jenwittayaroje & Jiraporn, 2017; Nguyen & Nielsen, 2010; Rosenstein & Wyatt, 1990; Yermack, 1996). Therefore, we include board size and independence as control variables. These variables are not included in the tests performed earlier because board characteristics are not available for all observations in the full sample. The regression result is shown in Table 7. The coefficient of UDL remains significantly positive even after controlling for board size and independence. Therefore, the effect of shareholder litigation rights remains robust even after controlling for internal governance.

Table 6
Placebo test based on the year before UDL is adopted.

	(1) ESG Controversies
UDL (t-1)	-3.321 (-0.749)
Firm Size	-2.110 (-0.918)
Leverage	-5.817 (-1.366)
Profitability	22.601** (2.476)
Capital Investments	-37.153 (-1.158)
R&D Intensity	-6.853 (-0.170)
Advertising Intensity	14.636 (0.218)
Dividend Payouts	-33.738 (-1.423)
Cash Holdings	-2.186 (-0.261)
Discretionary Spending	-14.692 (-0.986)
ESG score	-0.184*** (-3.046)
Constant	115.348*** (5.293)
Firm Fixed Effects	Yes
Year Fixed Effects	Yes
Observations	7883
Adjusted R-squared	0.300
Robust t-statistics in parentheses	
*** p < 0.01, ** p < 0.05, * p < 0.1	

The ESG controversies score is based on 23 ESG controversies issues, with recent controversies represented in the most recent complete period. Within each industry segment, a percentile rank algorithm is used. As a result, the score shows the extent to which a given business engages in ESG controversies in comparison to its industry counterparts. Refinitiv provides more specific information regarding the construction of the ESG controversies score. Universal Demand Laws (UDL) is a binary variable for a firm incorporated in a state where a universal demand law has been implemented in a given year, and zero otherwise. SG&A Expense is selling, general, and administrative expense. UDL (t-1) is equal to one for the year immediately before the passage of universal demand laws.

4.7. Accounting for ESG controversies that may be related to litigation

It may be suggested that the decline in ESG controversies is directly caused by the reduction of shareholder litigation rights, rather than its impact on managers' behavior. This is possible as some ESG controversies may have directly originated from shareholders' lawsuits. Ideally, it would be helpful to be able to remove the ESG controversies that are directly related to litigation from the rest of the ESG controversies. Unfortunately, such data are not available. Therefore, to address this issue, we attempt to remove the effect of the ESG controversies that are related to litigation. In doing so, we create a proxy for litigation susceptibility.

We assess litigation susceptibility using several factors that have been identified in the literature as relevant. First, Francis, Philbrick, and Schipper (1994), find that firms in the biotechnology, computers, electronics, and retail industries had the highest incidence of litigation. Following Francis et al. (1994), we create a binary variable equal to one if the firm belongs to one of these industries and zero otherwise.

In addition, we examine market capitalization, stock returns, and stock volatility. The probability of a lawsuit is associated with market capitalization since larger corporations are more inclined to settle with higher compensation to plaintiffs. As a result, they are more appealing as targets for litigation. Stock performance characteristics are correlated with the frequency of lawsuits as such cases are frequently prompted by

Table 7
Controlling for board characteristics.

	(1)
	ESG Controversies
Universal Demand Laws (UDL)	10.787*** (2.698)
% Independent Directors	-0.050 (-0.915)
Ln (Board Size)	11.052*** (2.888)
Firm Size	-2.114 (-1.293)
Leverage	1.865 (0.391)
Profitability	15.271*** (3.741)
Capital Investments	-5.918 (-0.364)
R&D Intensity	3.064 (0.147)
Advertising Intensity	-36.194 (-0.733)
Dividend Payouts	-14.604 (-0.612)
Cash Holdings	1.609 (0.245)
Discretionary Spending	-5.663 (-0.502)
ESG score	-0.117** (-2.389)
Constant	82.145*** (4.952)
Firm Fixed Effects	Yes
Year Fixed Effects	Yes
Observations	6310
Adjusted R-squared	0.364
Robust t-statistics in parentheses	
*** p < 0.01, ** p < 0.05, * p < 0.1	

The ESG controversies score is based on 23 ESG controversies issues, with recent controversies represented in the most recent complete period. Within each industry segment, a percentile rank algorithm is used. As a result, the score shows the extent to which a given business engages in ESG controversies in comparison to its industry counterparts. Refinitiv provides more specific information regarding the construction of the ESG controversies score. Universal Demand Laws (UDL) is a binary variable for a firm incorporated in a state where a universal demand law has been implemented in a given year, and zero otherwise. SG&A Expense is selling, general, and administrative expense. % of Independent Directors is the percentage of independent directors on the board. Board Size is the number of directors on the board.

big stock price drops and heightened stock return volatility surrounding the alleged fraud period (Alexander, 1991; Arena & Ferris, 2017; Dyl, 1999; Gande & Lewis, 2009; Skinner, 1997).

In summary, we assess litigation susceptibility using four variables that have been found in the literature to be related to litigation risk, i.e., industry membership, market capitalization, stock return, and stock return volatility. We use annual returns. For return volatility, we employ the standard deviation of daily stock returns. We construct a litigation susceptibility index by combining these four variables using principal component analysis (PCA). Essentially, PCA extracts the variation that these four variables have in common: the higher the index, the higher the probability of litigation.

Then, we regress ESG controversies on the litigation susceptibility index and keep the residuals, which represent the portion of ESG controversies that is unlikely related to litigation. We refer to this variable as adjusted ESG controversies because the effect of litigation has been removed. We then use this variable as the dependent variable in our regression analysis. The results are shown in Table 2A in the Appendix. Model 1 represents the entire sample. Model 2 is based on propensity score matching, and Model 3 is based on entropy balancing. The

coefficients of universal demand laws are still significantly positive in all regressions. Therefore, even after we remove the effect of litigation, our conclusion continues to hold.

4.8. Controlling for institutional ownership

It may be argued that our results may be driven by omitted variables, such as other external governance mechanisms than shareholder litigation rights. While possible, it is unlikely that our results are principally influenced by omitted variables. First, we include firm fixed effects, which account for any firm-specific unobservable characteristics that remain constant over time. Second, our identification strategy relies on a natural experiment using the staggered enactment of universal demand laws. It is exceedingly unlikely that certain omitted variables coincide with the staggered passage of universal demand laws and taint our identification strategy.

In any event, we execute an additional robustness check by including as a control variable institutional ownership, which is widely regarded as an external instrument of governance. The results are shown in Table 2A in the Appendix. We include as a control variable the percentage of institutional ownership. Model 1 includes the whole sample, while Model 2 and Model 3 represent propensity score matching and entropy balancing respectively. The results remain consistent with the coefficients in all regression significantly positive.

4.9. The effect of ESG controversies on profitability

In theory, ESG controversies should have a harmful effect. According to the legitimacy theory, accusations of questionable behavior have a detrimental effect on a company's brand and reputation (Aouadi & Marsat, 2016; Donaldson & Preston, 1995). Similarly, the stakeholder theory postulates that contentious business practices exacerbate stakeholder distrust and perceptions of corporate deceit (Aouadi & Marsat, 2016; Du et al., 2010; Maignan & Ralston, 2002), ultimately resulting in decreased trustworthiness (Godfrey et al., 2009; Yoon et al. 2006; Aouadi & Marsat, 2016). Additionally, agency theory suggests that self-interested management might steer the organization into taking controversial actions in order to benefit personally at the expense of shareholders (Jensen & Meckling, 1976). To complement our investigation of the effect of shareholder litigation rights on ESG controversies, we examine how ESG controversies affect firm profitability. According to theory, the effect should be negative.

Table 8 shows the regression results. We employ four alternative measures of corporate profitability, i.e., ROA, ROE, the EBIT ratio, and the profit margin. The coefficients of the ESG controversies score are all significantly positive, implying that companies embroiled in fewer ESG controversies experience significantly greater profitability. So, our results confirm the theoretical predictions about the adverse effect of ESG controversies. In terms of economic significance, we make the following calculations. The standard deviation of the ESG controversies score is 28.786. The coefficient of the ESG controversies score is 0.0002 in Model 1. So, a rise in the ESG controversies score by one standard deviation raises ROA by 0.0002 times 28.786, which is 0.0058. Because the standard deviation of ROA is 0.115, a rise by 0.0058 represents a 5.00% increase. The adverse effect of ESG controversies is not only statistically significant, but it is also economically non-trivial.

5. Conclusions

Theories suggest that ESG controversies matter. In addition, it has been reported that ESG scandals are associated with a sharp reduction in shareholder value (Frooman, 1997; Klassen & McLaughlin, 1996; Luo, 2021; Treepongkaruna et al., 2021a; Treepongkaruna et al., 2021b). Surprisingly, however, there is a scarcity of research on ESG controversies in the literature. We address this critical void in this paper. Leveraging as a quasi-natural experiment the staggered implementation

Table 8
The effects of ESG controversies on corporate profitability.

	(1)	(2)	(3)	(4)
	ROA	ROE	EBIT/Total Assets	Profit Margin
ESG Controversies Score	0.0002***	0.0004*	0.0001***	0.0003**
	(3.4836)	(1.6983)	(2.9892)	(2.5798)
% Independent Directors	-0.0000	0.0007	-0.0001	-0.0002
	(-0.1488)	(1.1217)	(-0.8464)	(-0.4570)
Ln (Board Size)	-0.0108	0.0559	-0.0066	-0.0110
	(-0.5555)	(0.8594)	(-0.3054)	(-0.3685)
Firm Size	-0.0063	-0.0855***	0.0028	-0.0191
	(-0.6559)	(-3.1165)	(0.3274)	(-0.8617)
Leverage	-0.2111***	-0.3220**	-0.1878***	-0.2402**
	(-3.4967)	(-2.1772)	(-3.1957)	(-2.1509)
Profitability	0.1097	0.2128	0.0862	0.0045
	(0.8439)	(0.7189)	(0.5767)	(0.0149)
Capital Investments	-0.7734***	-1.3353***	-0.0915	-1.3267***
	(-6.5370)	(-4.5947)	(-0.8502)	(-3.1729)
R&D Intensity	-0.3247	-2.2117	-0.3774	-0.2665
	(-0.9940)	(-1.6306)	(-0.8777)	(-0.7677)
Advertising Intensity	0.3630***	2.2308***	0.4422***	0.2752**
	(3.9905)	(5.2566)	(4.1204)	(1.9869)
Dividend Payouts	0.0007	0.0780	0.0015	-0.1501
	(0.0198)	(0.7811)	(0.0485)	(-1.1720)
Cash Holdings	0.0445	0.0653	0.1225**	0.0056
	(0.7256)	(0.3363)	(2.0519)	(0.0412)
Discretionary Spending	0.0002	0.0006	0.0003**	-0.0001
	(1.2356)	(0.9677)	(2.2486)	(-0.1914)
ESG score	0.1730**	0.7346***	0.1039	0.3650
	(2.1418)	(2.7323)	(1.6007)	(1.5025)
Firm Fixed Effects	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes
Observations	6310	6310	6310	6310
Adjusted R-squared	0.3449	0.1776	0.5008	0.2597
Robust t-statistics in parentheses				
*** p < 0.01, ** p < 0.05, * p < 0.1				

The ESG controversies score is based on 23 ESG controversies issues, with recent controversies represented in the most recent complete period. Within each industry segment, a percentile rank algorithm is used. As a result, the score shows the extent to which a given business engages in ESG controversies in comparison to its industry counterparts. Refinitiv provides more specific information regarding the construction of the ESG controversies score. Universal Demand Laws (UDL) is a binary variable for a firm incorporated in a state where a universal demand law has been implemented in a given year, and zero otherwise. SG&A Expense is selling, general, and administrative expense. ROA is net income divided by total assets. ROE is net income divided by total equity. Profit margin is net income divided by sales.

of universal demand laws, which raise the difficulty for shareholders to

Appendix A

Table 1A
Variable definitions.

Variable	Definition
<u>ESG</u> ESG Controversies Score	The ESG Controversies Score from Refinitiv indicates the percentile rank score of a firm's engagement in ESG controversial activities relative to its industry peers. The higher the score, the fewer ESG controversies the firm engages in
ESG Score	The ESG Score from Refinitiv indicates the percentile rank score of a firm's engagement in ESG activities relative to its industry peers. The higher the score, the more ESG activities the firm engages in
<u>Hostile Takeover Exposure</u>	

(continued on next page)

file lawsuits, we investigate how an exogenous reduction in shareholder litigation rights affects ESG controversies. In the context of corporate governance, the threat of shareholder lawsuits stands out as a particularly potent mechanism. The risk of shareholder litigation serves as a type of governance since it deters management from taking advantage of shareholders.

Based on a large sample of U.S. firms, our difference-in-differences analysis demonstrates that an exogenous decline in shareholder litigation rights reduces ESG controversies significantly. Our empirical findings corroborate the quiet life hypothesis, where managers desire to live a quiet life, preferring not to be entangled with controversial activities when more insulated from possible shareholder litigation. The impact of a reduction in litigation risk is not only statistically significant but is also economically meaningful. Specifically, an exogenous drop in litigation risk associated with the enactment of universal demand laws brings down ESG controversies by 40.85%. Finally, according to theory, ESG controversies are expected to corrode firm performance. Corroborating the theoretical predictions, we find a significant drop in firm profitability when there are more ESG controversies.

Because our identification strategy is based on a quasi-natural experiment using an exogenous shock, our conclusion is unlikely vulnerable to endogeneity and should reflect a causal effect. In any event, to ensure that our results are robust, we execute a variety of robustness checks, i.e., propensity score matching, entropy balancing, testing the parallel trend assumption, and a placebo test. All the robustness checks strongly validate our conclusion.

The results of our study offer several implications of practical value. First, we show that laws can have significant consequences on ESG controversies. When a specific law or regulation is under consideration, legislators should keep in mind that it might influence the extent to which companies are engaged in ESG controversies. Second, our study has important implications for shareholders, shareholder activists, and investors in general, who focus on corporate controversial activities and try to understand and influence ESG policies. Apparently, litigation risk is one of the most crucial factors when managers decide whether or not to have the firm engage in ESG controversies. Furthermore, researchers and policy makers benefit from our study. We show that the staggered passage of regulations across states over time can be used as a powerful identification technique. Researchers and policy makers can assess the impact of a specific law or regulation using this technique.

CRedit authorship contribution statement

Sirimon Treepongkaruna: Funding acquisition, Conceptualization, Project administration. **Khine Kyaw:** Data curation. **Pornsit Jiraporn:** Conceptualization, Methodology, Formal analysis, Writing - original draft, Writing - review & editing.

Table 1A (continued)

Variable	Definition
Universal Demand Laws	A binary variable for a firm incorporated in a state where a universal demand law has been implemented in a given year, and zero otherwise.
<u>Firm-specific Characteristics</u>	
Firm Size	Total Assets
Leverage	Total Debt/Total Assets
Profitability	EBIT/Total Assets
Capital Investments	Capital Expenditures/Total Assets
Advertising Intensity	Advertising Expense/Total Assets
R&D Intensity	R&D Expense/Total Assets
Dividend Payouts	Dividends/Total Assets
Cash Holdings	Cash Holdings/Total Assets
Discretionary Spending	SG&A Expense/Total Assets
<u>Board Attributes</u>	
% Independent Directors	Percentage of independent directors on the board
Board Size	The number of directors on the board

Table A2

The effect of shareholder litigation rights on ESG controversies controlling for litigation vulnerability

	(1)	(2)	(3)
	ESG Controversies (Adjusted)	ESG Controversies (Adjusted)	ESG Controversies (Adjusted)
Universal Demand Laws (UDL)	12.022*** (2.898)	16.835* (1.748)	22.099*** (2.813)
Firm Size	-2.031 (-1.460)	-3.336 (-1.057)	-2.308 (-1.007)
Leverage	-1.054 (-0.299)	-6.508 (-0.875)	-5.339 (-1.244)
Profitability	15.516*** (4.380)	3.121 (0.321)	21.351** (2.337)
Capital Investments	8.633 (0.769)	-44.093 (-0.986)	-36.725 (-1.155)
R&D Intensity	19.713 (1.256)	-46.166 (-0.998)	-4.004 (-0.098)
Advertising Intensity	-57.886 (-1.467)	31.937 (0.448)	16.841 (0.256)
Dividend Payouts	-21.518** (-2.093)	-54.663 (-1.397)	-32.637 (-1.385)
Cash Holdings	2.368 (0.442)	-22.216 (-1.560)	-2.386 (-0.286)
Discretionary Spending	-10.109 (-1.000)	-9.662 (-0.441)	-16.197 (-1.082)
ESG score	-0.150*** (-3.404)	-0.163* (-1.922)	-0.180*** (-3.008)
Constant	22.702* (1.705)	36.109 (1.180)	21.532 (0.969)
Firm Fixed Effects	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes
Observations	7883	1828	7883
Adjusted R-squared	-0.104	-0.045	-0.094
Robust t-statistics in parentheses			
*** p < 0.01, ** p < 0.05, * p < 0.1			

We assess litigation susceptibility using four variables that have been found in the literature to be related to litigation risk, i.e., industry membership, market capitalization, stock return, and stock return volatility. We use annual returns. For return volatility, we employ the standard deviation of daily stock returns. We construct a litigation susceptibility index by combining these four variables using principal component analysis (PCA). Essentially, PCA extracts the variation that these four variables have in common: the higher the index, the higher the probability of litigation. Then, we regress ESG controversies on the litigation susceptibility index and keep the residuals, which represent the portion of ESG controversies that is unlikely related to litigation. We refer to this variable as adjusted ESG controversies because the effect of litigation has been removed. We then use this variable as the dependent variable in our regression analysis.

Table 3A

The effect of shareholder litigation rights on ESG controversies controlling for institutional ownership.

	(1)	(2)	(3)
	ESG Controversies	ESG Controversies	ESG Controversies
Universal Demand Laws (UDL)	10.044*** (2.819)	14.937* (1.803)	11.771*** (3.746)
Firm Size	-1.243	-5.148	-2.249

(continued on next page)

Table 3A (continued)

	(1)	(2)	(3)
	ESG Controversies	ESG Controversies	ESG Controversies
Leverage	(−0.821)	(−1.142)	(−0.812)
	4.560	−5.459	−2.720
	(1.076)	(−0.570)	(−0.490)
Profitability	16.972***	31.145**	24.274***
	(4.662)	(2.333)	(2.733)
Capital Investments	10.775	−7.777	−17.648
	(0.808)	(−0.204)	(−0.723)
R&D Intensity	21.745	−69.868	−8.807
	(1.226)	(−1.076)	(−0.195)
Advertising Intensity	−46.166	−10.452	−5.193
	(−0.867)	(−0.079)	(−0.052)
Dividend Payouts	−30.356***	−49.737	−24.357
	(−3.125)	(−1.440)	(−1.009)
Cash Holdings	5.706	−10.483	2.385
	(0.971)	(−0.602)	(0.263)
Discretionary Spending	−7.731	−16.013	−15.578
	(−0.757)	(−0.691)	(−0.878)
ESG score	−0.152***	−0.169*	−0.170***
	(−3.189)	(−1.889)	(−2.840)
% Institutional Ownership	7.449**	7.590	9.581**
	(2.161)	(1.194)	(2.176)
Constant	91.449***	128.224***	101.461***
	(6.258)	(2.952)	(3.833)
Firm Fixed Effects	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes
Observations	6602	1543	6602
Adjusted R-squared	0.348	0.290	0.273

Robust t-statistics in parentheses.

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

The ESG controversies score is based on 23 ESG controversies issues, with recent controversies represented in the most recent complete period. Within each industry segment, a percentile rank algorithm is used. As a result, the score shows the extent to which a given business engages in ESG controversies in comparison to its industry counterparts. Refinitiv provides more specific information regarding the construction of the ESG controversies score. Universal Demand Laws (UDL) is a binary variable for a firm incorporated in a state where a universal demand law has been implemented in a given year, and zero otherwise. SG&A Expense is selling, general, and administrative expense. Institutional ownership is the total percentage of institutional ownership.

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