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CRIME, PUNISHMENT AND THE HALO EFFECT OF CORPORATE SOCIAL RESPONSIBILITY

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ABSTRACT

Three reasons are often cited for the value of corporate social responsibility: product quality signalling, delegated giving, and the halo effect. Previous tests cannot separate these channels because they focus on consumers, who value all three. We focus on prosecutors, who are only susceptible to the halo effect. Using Foreign Corrupt Practices Act enforcements, we find that social responsibility is associated with 2 million dollars less in fines, though it is uncorrelated with bribe characteristics and cooperation, which should entirely determine sanctions following Becker (1974). We show that this bias is likely a halo effect and not prosecutorial conflict of interest.

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1 Introduction

Social responsibility is an important aspect of corporate strategy. From Google to General Electric (GE) and from Intel to Starbucks, corporations regularly spend hundreds of millions of dollars on community, philanthropic, environmental and employee satisfaction programs.¹ Similarly, they might forego billions in revenue streams that are morally questionable.² According to a 2009 McKinsey Survey, two-thirds of CFOs and three-quarters of investment professionals embraced the notion that corporate social responsibility adds to shareholder value. In particular, they believed that the value added is tied to promoting a good corporate image.

There are three economic channels through which strategic corporate social responsibility (CSR) might create value. All three revolve around improving corporate image.³ The first channel is that CSR is costly signalling of product market quality (see, e.g, Milgrom and Roberts (1986)). An example of CSR as costly signalling is GE commercials that showcase GE's windmills in the wheat fields of the American heartland.

The second channel is that CSR is delegated giving, whereby firms are well-positioned to also help consumers engage in charitable giving (Becker, 1974a; Andreoni, 1989) because of complementarities involving goodness in the production function (Besley and Ghatak, 2005). In this case, consumers have delegated their giving to GE so that when they buy GE lightbulbs, they know they are contributing to the preservation of nature. The consumer would be willing to donate directly to this cause but GE is simply more knowledgeable and economies of scale make them better able to contain the fallout of their supply chain.

The third channel through which CSR might be valuable is that it generates a halo effect, a cognitive bias long documented by psychologists (see, e.g., Thorndike (1920), Nisbett

¹For example, in the mid-2000s, Google initiated its famed 1% program, which invested 1% of its profits in philanthropic and non-profit interests. In the late 2000s, General Electric spent \$160 million for community and employee philanthropic programs and earmarked billions more for the development of eco-friendly products. At the same time, Intel spent \$100 million for global education programs and energy conservation (see, e.g., Hong, Kubik, and Scheinkman (2011)).

²The most recent high profile example is CVS Pharmacy's plan in 2014 to stop selling cigarettes at all retail locations. This move is forecasted to cost \$2 billion a year in direct sales but their press release suggested that this strategy was meant to improve the company's image as a health-care provider (see, e.g., Cheng, Hong, and Shue (2013)).

³See Heal (2005) and Benabou and Tirole (2010) for reviews of the literature.

and Wilson (1977)) in which one's judgment of a person's character can be influenced by one's overall (and usually first) impression of him or her, with little actual knowledge of the individual. Consumers have been shown to respond to surveys and polls consistent with a halo effect for corporate social responsibility (Klein and Dawar, 2004; Sen and Bhattacharya, 2001). Halo effect considerations also seem to influence how businesses are run. Car companies, for instance, will roll out what they call a halo vehicle, a particular model with special features that helps sell all the other models in the range. In other words, consumers use the fact that a firm cares about the wheat fields of America to (over-) extrapolate that it also produces great lightbulbs.

A large literature, dubbed "doing well by doing good", has long tried to separate these three channels using panel data on US corporations and their CSR activities (Benabou and Tirole, 2010; Heal, 2005; Margolis, Elfeinbein, and Walsh, 2009; Kitzmueller and Shimshack, 2012). Yet it has been difficult to separately identify the economic value of each of these three sources. The best evidence thus far has come from experiments. For instance, Elfeinbein, Fisman, and McManus (2012) study eBay sellers to isolate a product signaling effect and Smith, Read, and Lopez-Rodriguez (2010) use student experiments to show that CSR might engender a halo effect for consumer products. But the extrapolative relevance of these experiments for large corporations has not been established. At the same time, field and case studies such as Vanhamme and Grobbsen (2009), who study corporate crises, and Barrage, Chyn, and Hastings (2014), who focus on British Petroleum's oil spill, establish the effectiveness of advertising in countering negative consumer perceptions. But even in these clever field or experimental studies, it is not always easy to separate costly signalling, delegated giving, and the halo effect. For instance, firm spending on CSR in order to better weather corporate crises might be consistent with all three channels.

One major reason for this difficulty is that all existing tests focus on consumers. However, it is difficult to disentangle the three effects because consumers value all of them. To avoid this problem we focus on federal prosecutors, who are only potentially susceptible to the halo effect. We study the penalties issued by the US Department of Justice and the SEC for violations of the Foreign Corrupt Practices Act (FPCA) during the period 1990-2013.

We focus on this setting for four reasons. First, these prosecutors do not consume a

company's product when they decide on an appropriate punishment, so they do not value signalling through advertising or product bundling with delegated giving. On the other hand, courtrooms are exactly the type of setting in which the halo effect is likely to manifest itself. The earliest psychology studies of halo effects focused on the classroom and judicial affairs and the notion that attractive people are thought by jurors to be less likely to commit a crime.

Second, there is a clear benchmark of optimal punishment and deterrence (Becker, 1974b; Polinsky and Shavell, 1992) (hereafter Becker-Polinsky-Shavell), where bribe characteristics and the firm's cooperation with the investigation (Arlen, 1994; Arlen and Kraakman, 1997) should entirely determine the amount of the fine. Since Becker (1974b), this body of work has argued that as long as the offending party can pay, optimal punishment should focus on fines and set them proportional to the expected harm done. This principle of proportionality gets the potential offending party to internalize the costs of the crime with the expected benefit from the crime. In other words, unbiased prosecutors should levy fines equivalent to the expected harm done and lower fines for firms that cooperate with the investigation since it lowers the fixed cost of investigation.

Third, FCPA cases come with detailed information on bribe characteristics such as payments and the number of years the bribe has been going on, which allow us to proxy for expected harm and also measure any underlying differences in the bribing behavior of firms. These cases also have press releases, which we are able to text-mine to determine whether the firm was cooperative or compliant (see Choi and Davis (2013)).

And fourth, unlike other types of corporate crime such as accounting fraud, which almost always involves the CEO, CFO or other upper management, bribes often do not involve top firm executives.⁴ While the fraud is committed by individuals farther down the organizational hierarchy, FCPA prosecutions typically also involve separate actions against the firm as a whole. This makes FCPA enforcement a more fitting setting than fraud to measure halo effects generated by a firm's image or reputation.

Indeed, earlier empirical work, testing Becker-Polinsky-Shavell using FCPA sanctions,

⁴See Bergstresser and Philippon (2006) for instances and evidence of CEO manipulation and accounting fraud.

show that fines rise with the bribe payment amount and vary with a host of other characteristics that capture the expected harm of the bribe, such as the country in which the bribe was paid (Choi and Davis, 2013; Karpoff, Lee, and Martin, 2014).⁵ These explanatory variables generate a sizeable R^2 of around .6 to .8.

It is straightforward to map the halo effect to this literature to construct a null hypothesis. To the extent that a firm’s social responsibility is not correlated with the expected harm or other bribe characteristics such as cooperation, it should not explain the sanctions in this optimal fines benchmark. But if prosecutors are influenced by a halo effect and over-extrapolate from a firm’s CSR to bribe harm, we expect higher CSR firms to nonetheless receive lower fines.

We measure corporate social responsibility using the most comprehensive and standard scores in the literature, the Kinder, Lydenberg and Domini (KLD) scores of CSR. KLD scores are developed by a for-profit company, akin to a credit rating agency. The scores measure firm-level social responsibility along the lines of community relations, product characteristics, environmental impact, employee relations, diversity and governance. KLD scans public databases, such as those on employee strikes and Environmental Protection Agency (EPA) violations, and uses a team of analysts to measure these and other social responsibility dimensions of firm production. The final KLD score is a sum of indicators for a various socially responsible attributes or actions. We explain in Section 3 why these scores are a reasonable, albeit imperfect, proxy for social responsibility.

We first establish that there are no differences in these bribe characteristics across lower versus higher KLD firms. Using a variety of metrics, we find no fundamental difference in the bribing behavior of more or less socially responsible firms. We also find that high KLD firms are no more likely to be cooperative or compliant with the investigation, as measured by the textual analysis of prosecutorial case files.

We then show that KLD nonetheless significantly influence sanctions. Our best estimate

⁵Choi and Davis (2013) interpret the strength of various explanatory variables as support for four different theories of the relationship between bribes and sanctions. Since all of these can be interpreted as manifestations of the Becker-Polinsky-Shavell model, we focus instead on deviations from this model. Karpoff, Lee, and Martin (2014) focus on the effects of bribery and fraud charges on firm value. They find that commingled charges, which include both bribery and fraud violations, have especially large reputation effects. However, they do not result in significantly different sanctions.

is that a one point increase in the KLD score results in an average reduction in sanctions of around 2 million dollars relative to the Becker-Polinsky-Shavell optimal fine benchmark. This is a substantial change in punishment, equal to 40% of the median sanction or 10% of the mean sanction. The point estimates across specifications range from 1.5 to 2.5 million dollars for a one point increase in KLD. According to KLD guidelines, a one point increase in KLD requires a firm to change one corporate social responsibility indicator from a concern to neutral, or from neutral to a strength. For example, a company would need to implement a “notable strong retirement benefits program”. Or, if it had an underfunded or subpar retirement benefits program in place, it would need to improve its funding or increase benefits.⁶

We also exploit the fact that the FCPA only became widely enforced after 2007 to address the possibility of reverse causality. We show that KLD scores in 2007 and various measures of lagged KLD scores are also negatively correlated with sanctions. These past CSR scores were not set in response to FCPA fines and so CSR influences fines, rather than the other way around.

Although we establish a bias in sanctions, this bias could have various root causes. We show that in practice there is deviation from the optimal benchmark in which unbiased prosecutors set fines by taking into account only bribe characteristics and cooperation. However, this prosecutorial bias does not necessarily have to be due to a psychological or expectational bias in the form of the halo effect. It could be due to other incentives such as conflicts of interest. One natural source of such bias is that the prosecutors may take into account the political power of firms to avoid running afoul of those that are more powerful.

To further separate this bias from a psychological bias due to the halo effect, we gather data on firm’s contributions to political campaigns. We show that sanctions are not lower for those firms that contribute more to political campaigns. We then use text mining to establish that the effects of KLD stem from the positive emotions of the prosecutors. We find that press releases that display more positive emotion are associated with higher KLD firms. In other words, it appears that the lower sanctions obtained by high KLD firms are

⁶We also break down KLD scores into their subcomponents to determine which are most relevant for FCPA fines. CSR related to community, products, and employees have the strongest explanatory power, whereas diversity, environment, and governance do not.

reflected in the emotional tones of their press releases.

Our study focuses exclusively on fines levied in FCPA cases. Conditional on being prosecuted under the FCPA, we establish that a firm's corporate social responsibility is associated with lower fines relative to the benchmark of optimal fines. We might also be interested in testing for a halo effect in the decision of whether or not to prosecute firms that may have violated the FCPA. However, this is much more challenging because we do not observe the sample of cases under consideration for prosecution, so we focus only on conditional fines in this paper.

One implication of our analysis is that firms might very well have a strategic motive to be socially responsible as a form of insurance in case of unfavorable regulation. Our work cannot pin down how important such halo considerations are for corporations when deciding CSR, only that there are likely to be positive effects on regulators when CSR is higher. This does not mean that currently observed levels of CSR are optimal. Indeed, recent and well-identified work shows that there is likely to be over-investment in CSR due to agency problems (Bertrand and Mullainathan, 2003; Cronqvist, Heyman, Nilsson, Svaleryd, and Vlachos, 2009; Cheng, Hong, and Shue, 2013). On the other hand, some have argued there is not enough CSR because stock markets are too short-termist (Bolton and Samama, 2013) and do not place enough value on the intangible aspects of CSR (Edmans, 2011). More broadly, our paper contributes to a burgeoning literature on moral finance as argued for in Haidt, Hirshleifer, and Teoh (2013) and Erhard and Jensen (2013) and also the already important literature of behavioral corporate finance (see Baker and Wurgler (2011) for a survey).

Our paper proceeds as follows. We provide background on FCPA sentencing guidelines, particularly as it relates to discretion over company character, in Section 2. We describe KLD scores in Section 3. We describe and summarize our data in Section 4. We collect our main empirical methodology and results in Section 5. We conclude in Section 6.

2 FCPA and Sentencing Guidelines

The Foreign Corrupt Practices Act (FCPA) of 1977 was passed in response to the realization that bribery was prevalent and the idea that bribery by some US firms was detrimental to the reputation of US firms overall. The report to the House of Representatives that initially introduced the FCPA outlined the reasoning behind this legislation. In recent years, more than 400 companies admitted making illegal payments to foreign government officials, 117 of which were in the Fortune 500.⁷ These actions were thought to undermine the free market system championed by the U.S. and harm foreign policy by lowering its credibility. Not only were these actions judged as harmful, but a survey of corporations cited in the report indicated that bribery was not deemed necessary by companies in a variety of industries and of various sizes. As a result, the FCPA made it illegal for any US issuer, domestic concern, or other person to bribe a foreign official in order to influence his acts or decisions or those of his government or political party.

The number of cases prosecuted under the FPCA has grown rapidly in recent years, prompting Choi and Davis (2013) to name the anti-bribery provisions of the FCPA as the most important rules in the regulation of US business abroad. As shown in Figure 1, there were quite few cases against corporations in the 1990s and early 2000s but the number ballooned after 2007. A total of 15 cases were brought against corporations in the period 1991-2000 but this rose to 185 in 2001-2010. This is partially due to the changing nature of US business involvement. At least twenty percent of the cases in the 2000s took place in Iraq and at least 15 percent took place in China. But much of the increasing popularity of the FCPA was due to the growing use of deferred prosecution and non-prosecution agreements (DPAs and NPAs) to settle these charges. These made it easier for prosecutors to pursue numerous cases. Regardless of the reasons, this surge in FCPA enforcement allows us to shed light on prosecutorial practices by comparing sanctions for companies with differing levels of corporate social responsibility.

The enforcement approach of the FCPA is detailed in *A Resource Guide to the U.S. Foreign Corrupt Practices Act*, published in the Criminal Division of the U.S. Department

⁷<http://www.justice.gov/criminal/fraud/fcpa/history/1977/houseprt-95-640.pdf>

of Justice and the Enforcement Division of the U.S. Securities and Exchange Commission. The penalties detailed in this guide leave room for prosecutorial discretion. The initial “offense level” depends on the details of the bribe, such as the amount of money paid and the cooperation of the offender. This base is then scaled by a “culpability score” which can reduce the fine to 5% of the base or raise it to 400%. This culpability score depends on firm characteristics such as prior misconduct and the character of the company. Crucially, it depends on the prosecutor’s interpretation of firm characteristics. This discretion makes FCPA sanctions highly susceptible to the halo effect. Although the prosecutors do not consider the company’s product or attitude toward employees when deciding on a sanction, it is quite likely that a firm’s reputation for social responsibility would influence his or her opinion of the severity of the crime.

The prosecutor’s opinion is particularly influential for the enforcement of the FCPA. This is because most cases are decided by the prosecutor rather than a judge. The prevalent use of DPAs and NPAs in the criminal charges handled by the Department of Justice means that charges are not actually filed against many companies. In the cases when companies are actually charged, they are likely to be resolved through a plea agreement. The civil cases handled by the Securities and Exchange Commission follow a similar theme, with most resolved through a settled civil complaint. Both of these policies give prosecutors a good deal of discretion in setting sanction amounts.

3 The Feasibility of Measuring Social Responsibility

To measure corporate social responsibility, we use annual scores compiled by Kinder, Lydenberg and Domini (KLD) Research & Analytics, Inc. These scores were first collected in 1991 for 488 firms and coverage grew over the years to include 2,894 firms in 2009. After 2009, the calculations of KLD scores changed. Therefore we use current KLD score to measure firm goodness if the FCPA action was before 2009. If the action is in 2009 or later, we use the KLD score from 2009. On average there are roughly 1,486 firms covered in every year. To calculate corporate social responsibility, firms are graded on roughly 60 indicators. Each indicator represents a strength or a concern in one of six major areas: community, corporate

governance, diversity, employee relations, environment, and product. The total strengths, net of the total concerns, are summed together to calculate a single KLD score.

The advantages and disadvantages of the KLD score as a measure of firm goodness are well known. One major advantage of the KLD score is that it is a broad measure which covers many different aspects of corporate social responsibility. The indicators capture aspects that are difficult to quantify, such as community backlash or controversial products. Although it is not as precise as other measures, it is able to include more of the factors that play into corporate social responsibility. The disadvantage of this measure is that, like most ratings produced by commercial firms, there is a black-box aspect to the KLD score. Ideally, one would have data on dollar amounts spent on corporate social responsibility. Unlike an extra dollar of charitable donations, it is unclear what exactly an increase in the KLD score represents. As a result, there is skepticism about what exactly these scores capture. One particular concern is that CSR is nothing more than cynical greenwashing with little economic implications. This greenwashing comprises nothing more than some year-end reports about various recycling initiatives or seminars that are not very costly.

However there is evidence in the literature that the equal-weighted KLD scores, while undoubtedly noisy, are signals of corporate social responsibility. First, Chatterji, Levine, and Toffel (2009) find that KLD scores which capture the past environmental performance of firms also forecast the probability of future pollution and environmental regulatory violations reasonably well, though other categories of KLD scores are noisier. Second, Cheng, Hong, and Shue (2013) provide some anecdotal evidence using the famous examples of Apple and Google for the effectiveness of aggregate KLD scores in picking up the timing of changes in social responsibility. Third, Hong, Kubik, and Scheinkman (2011) show that a principal components analysis places roughly equal weights across five dimensions of CSR: community relations, product characteristics, environmental impact, employee relations, and diversity. They show that there is a common component in firm scores. Firms that score well in one dimension (e.g. community) also score well in another (e.g. environment). If the KLD scores only represented greenwashing, we would expect firms with very poor scores in one area make up for it in another by appearing more environmentally friendly. This does not appear to be the case.

Fourth, Cheng, Hong, and Shue (2013) also gathered donation data from the Chronicles of Philanthropy for approximately 100 large firms each year, chosen from Fortune magazine’s list of top revenue-producing firms in the US. They find that equal-weighted KLD scores predict donations well in annual levels. Fifth, KLD scores are widely used by socially responsible investment (SRI) funds to screen out irresponsible companies from their indexes. SRI funds typically own stocks with the highest KLD scores within an industry. Additionally, Hong and Kostovetsky (2012) find that money managers of non-SRI funds who have, on net, contributed towards Democratic candidates in elections, and whose political values are thus likely to favor social responsibility, tilt their portfolios toward firms with the highest KLD scores within industries. DiGiuli and Kostovetsky (2011) find that firms with Democratic CEOs are also more likely to have higher KLD scores. In other words, these KLD scores are correlated with the values of investors and CEOs. In sum, the preponderance of the evidence establishes KLD as an informative measure of a firm’s genuine attempts to address the impact of their production on society.

4 Data and Summary Statistics

We start with a sample of 271 cases against corporations starting in 1991, the first year in which KLD scores are available. The data on FCPA cases is taken from the website of the law firm Shearman & Sterling LLP. In 101 of these cases, we can match the defendant’s name to a company name in the KLD database. The characteristics of these cases are summarized in Table 1. The average firm involved in one of these FCPA cases has a market capitalization (Market Cap) of 27.86 billion dollars, with a median of 5.7 billion. These are larger than the average firm for which KLD is measured, consistent with the fact that multinational firms are larger and also have more opportunities to engage in foreign bribery. The mean and median KLD score are both around -1. In contrast, the average KLD across all firms surveyed in similar years is 0.1 and the median is 0.⁸ US Company is a dummy variable

⁸Notice that the KLD scores of firms in the FCPA sample are slightly lower than those of other firms. This suggests that higher KLD firms are less likely to be prosecuted under the FCPA. This could be due to a number of different factors, one of which is a halo effect in the selection of firms to prosecute. We discuss this at the end of the paper.

that is equal to 1 if the firm is headquartered in the US and zero otherwise. The majority of these companies, 87%, are headquartered in the US, as expected given the jurisdiction of the FCPA.

Table 1 also describes the details of the bribes for which the firms are being prosecuted. The mean sanction is 20.3 million dollars and the median is 5.23 million dollars. The mean bribe involves a payment (Payments) of 9.26 million dollars. The median payment is 2 million dollars. The number of years of bribery (i.e. how long the bribes went on) has a mean of 5.78 years and a median of 5 years. The FCPA cases also report the value of business gained by the firm as a result of the bribes. The mean gain is calculated to be 300 million dollars with a median of 98.2 million dollars. Notice that on average the value of business gained is much larger than the sanction. This is to be expected because the value represents the revenue gained by the business, not the profit, and because for some bribes the value to a business could exceed the harm to society. Optimal fines do not aim to recoup the business gained due to the bribe but only the harm it caused.

Many of the cases span multiple countries and jurisdictions; 40% take place in more than one country and 15% are part of a foreign investigation. The data also imply that the bribes in question are usually related to a wider pattern of firm bribery. Eighty percent of offending firms are involved in multiple ongoing trials at once, although these tend to be clustered in time since only 7% of cases stem from a repeat offense by a firm. Emphasizing the fact that these bribes are committed by larger firms, in 51.5% percent of the FCPA actions related companies are involved, generally subsidiaries.

Tables 2 and 3 further explore the types of industries and countries involved in these cases. We use the Fama-French 17 industry portfolios to classify firms but only 12 of the industry classifications have some representation. The majority of cases are assigned to the “Other” industry, meaning their industries are specific enough that they do not belong to any of the sixteen other broad industry classification.⁹ The most commonly represented industries are machinery, oil and food. In line with the report to the House of Representatives, offenses do not appear to be concentrated in any one industry.

⁹In the sample, these include firm that deal with data processing, computer systems, radio and communications equipment, among others.

There is also a good deal of disparity across countries, with a majority of bribes taking place in China (28 cases) and Iraq (20 cases). In this table, we do not display all countries but just those with at least 3 FCPA violations. The total number of observations is greater than the 101 cases in our sample because each FCPA case may involve multiple countries.

5 Results

5.1 Optimal Fines Benchmark

There is a sizeable literature in law and economics going back to Becker (1974b) that has examined the determinants of sanctions or fines, notably modeled by Polinsky and Shavell (1992). Recent papers examining the empirical specifications for the FCPA include Choi and Davis (2013) and Karpoff, Lee, and Martin (2014). The optimal fine derived in the most basic version of Becker-Polinsky-Shavell type model has the following form:

$$E[Sanction_i] = a + kE[Harm_i]$$

where *Sanction* is the sanction or fine. It is set equal to a , a constant that captures the fixed cost of enforcement, and is proportional to the harm done by the crime $E[Harm_i]$.¹⁰ The intuition for this optimal fine is that sanctions are set to recoup the fixed costs of enforcement for society and to equate the firm's expected sanction (the sanctions level scaled by the probability of detection) with the expected harm. Because the firm trades off the private benefits of the bribe with the expected sanction, it will only choose to bribe when the private benefit outweighs the total harm.

The empirical literature on the FCPA has used observable bribe characteristics to proxy for the harm done in each bribery case, i.e.

$$E[Harm_i] = dB_i$$

where B_i includes variables such as the size of the bribe payment, the estimated value that

¹⁰The coefficient reflects factors such as the probability of detection.

the firm gained from the bribe, and the number of years over which the bribery occurred. The types of countries in which the bribe occurred may also influence harm. Another important determinant of optimal fines following corporate crime is cooperation and compliance with the authorities, as detailed by Arlen (1994); Arlen and Kraakman (1997). More cooperative firms should be assigned lower fines, all else equal, because they reduce the fixed cost of investigation for prosecutors. To account for this enrichment of the benchmark model, we control for these variables in later specifications. We will consider all the above bribe characteristics, and more, in our empirical analysis.

Our regression specification is motivated by a model where

$$E[Harm_i|KLD_i] = -cKLD + dB_i,$$

whereby prosecutors over-extrapolate that a high KLD firm imposed less harm for any given set of bribe characteristics B_i . This halo effect is in the spirit of psychology studies such as Thorndike (1920) in which jurors assume some positive trait (such as good looks) spills over into estimates of guilt or harm.¹¹ We will show below that KLD is uncorrelated with B_i , which makes it unlikely that KLD is a proxy for higher order moments of B_i or unobservable bribe characteristics.

Substituting the above expression for $E[Harm_i|KLD_i]$ into the equation for optimal sanction gives us an expression for $E[Sanction_i|KLD_i]$, the expected sanction upon getting caught, conditional on KLD. This motivates the regression specification for our test of the halo effect of corporate social responsibility. We estimate

$$Sanction_i = \beta_0 + \beta_H KLD_i + \beta_B B_i + \varepsilon_i$$

where the outcome variable $Sanction_i$ is the punishment, as measured by the sanction assigned for FCPA case i . The variable KLD_i is the firm's overall KLD score in our main specification and the coefficient β_H identifies the halo effect. It represents the change in punishment for bribery offenses for firms with higher corporate social responsibility, hold-

¹¹One might also think that d is a function of KLD where $d'(KLD) < 0$. This would be true if prosecutors assumed that equally egregious bribes translate into less harm for more socially responsible firms. We have examined both settings but our baseline case is the simpler one.

ing all else equal. If we can measure bribe characteristics well enough, which the literature suggests we can, then firm characteristics, even beyond *KLD*, should not come into play in determining sanctions under the benchmark of optimal fines by unbiased prosecutors.

In subsequent regressions we also explore the importance of various subcategories of KLD. The details of the bribe are captured by B_i . In choosing relevant bribe and country characteristics, we were guided by our reading of the *Resource Guide* and by factors that Choi and Davis (2013) found relevant.

For every bribe we include the amount of bribe payments and the value gained by the firm as a result of the bribe. When these variables are missing, we use the sample mean and include an indicator for missing variables. We also include in B_i the number of years the bribe spans and indicators for whether there are multiple parties involved in the bribe, whether it is being investigated by a foreign entity, whether it occurred in multiple countries, whether it is a repeat offense by the firm, and whether the offender is a US company. We also include fixed effects for the year in which the FCPA case was resolved and an indicator for whether the prosecution was by the DOJ or SEC.

Our main specification uses firm KLD without accounting for industry. However, we have also tried to account for the fact that more socially responsible industries may be looked upon more favorably in general. We have tried controlling for industry fixed effects and have also tried controlling for the average KLD score of a firm's industry, to reduce the number of explanatory variables. Results do not change quantitatively after controlling for average industry KLD and are qualitatively similar but understandably less significant when we use industry fixed effects instead.

5.2 Similar Bribe Characteristics in High and Low CSR Firms

In Table 4 we explore how bribe characteristics vary with KLD, after controlling for year fixed effects. If it were true that high KLD firms tend to engage in less harmful bribes, we would expect bribe payments and bribe value to decrease with KLD, as well as the likelihood of other harmful bribe characteristics.

The first result in Table 4 shows how bribe payments and value vary with firm KLD. Columns (1) and (3) include all observations while columns (2) and (4) are winsorized at the

95% level. We see that in all columns, there is no significant relationship between KLD and payments or between KLD and the value gained from bribery. In the remainder of Table 4, we examine how KLD scores influence other bribe characteristics. We show the relationship between KLD and every bribe characteristic that we have available and have used as a control in previous regressions. All regressions control for year fixed effects. The second set of results focuses on the details of the bribery itself: whether it occurred in multiple countries, the number of years it spanned, and whether a subsidiary or related party were involved. The third set of results focuses on prosecution: whether this was a repeat prosecution under the FCPA, whether there was an ongoing foreign investigation or other trial, and whether the prosecution was by the DOJ.¹² The final set of results focuses on the characteristics of the countries in which the bribery occurred.

Although there are some statistically significant differences in bribe characteristics, they do not portray higher KLD firms as consistently engaging in either more or less harmful bribery. Higher KLD firms are less likely to have a related party involved, making the firm itself more culpable. These firms are also more likely to be involved in a foreign investigation, increasing the expected harm. However, countries in which they bribe tend to be slightly richer and have stronger rule of law and more effective governments, which might suggest that bribes are less harmful. Altogether it seems that while higher KLD firms vary slightly on bribe characteristics, there is no indication that these differences display a systematic bias toward less harmful offenses.

When considering such a large number of dependent variables at once, it is important to remember that spurious but statistically significant coefficients might arise. To counteract this problem of multiple joint hypotheses, we apply the Bonferroni correction to the regressions in Table 4. After this correction, only the effects of KLD on Rule of Law are significant at either the 5% or 10% level. Even with this difference, the effect of KLD on sanctions extends far beyond the effects of rule of law.¹³

¹²The repeat offense indicator generally measures staggered prosecutions. For all but one of the firms with a repeat offense, the offenses were discovered around the same time but prosecuted at different speeds. The one exception in our data is IBM, which faced a complaint in 2011 following a separate FCPA action in 2000. Despite being the only real repeat offender, IBM is also the most socially responsible firm in our sample.

¹³In Table 4 we estimate that a one point increase in KLD leads to an increase of 0.08 in Rule of Law. We later show in Table 6 that a one point increase in Rule of Law is associated with a 5.6 million decrease in sanctions. Multiplying the two together, this can only explain a decrease of 0.4 in the FCPA sanction.

In short, there is little evidence that the bribes of higher KLD firms are less likely to be harmful. To add further credence to this argument, we check the effect of KLD on sanctions while not controlling for bribe characteristics. That is, we only control for year fixed effects and whether the firm was in the US. Regardless of winsorization, we find that the coefficients on KLD were similar to the specification with full controls. This demonstrates that bribe characteristics are likely to be orthogonal to the relationship between KLD and sanctions. Overall we can conclude that good and bad firms engage in similarly harmful bribery and that the variation in sanctions is driven by prosecutorial bias rather than by the true harm of the bribe.

5.3 Firm CSR and Deviation from the Optimal Fines Benchmark

The results of the regression analysis are presented in Table 5. Due to the small size of our sample, we are highly sensitive to relying on outliers for our result. To moderate the potential influence of outliers, we show the results for a number of different specifications. Column (1) includes all observations. In column (2), sanction, value, and payments are winsorized at 2.5% and 97.5%. In column (3), these variables are winsorized at 95%.¹⁴

In all three specifications of Table 5 firms with higher KLD receive significantly lower sanctions, all else equal. The results in column (3) reflect our preferred regression specification, which is careful to avoid any effects that may be driven by outliers. The coefficient on KLD is -1.736 and is significant at the 5% level. This means that a one point increase in the KLD score results in an average reduction in sanctions of 1.736 million dollars. The median sanction amount is 5.23 million dollars and the mean sanction amount is 20.3 million dollars. Therefore a one point increase in KLD corresponds to decline equal to 33% of the median sanction and 9% of the mean sanction. By both measures, this is a sizeable change in punishment. A one standard deviation increase in KLD within the bribe sample would shift the KLD score up by 2.83 points, resulting in a sanction reduction of roughly 4.9 million dollars.

It is also instructive to consider the effects of other covariates on the FCPA sanction. As

¹⁴We have also run all regressions using the logs of sanctions, value, and payments. Results are qualitatively similar but have a lower R^2 .

found in the literature, the bribe payment amount (Payments) is associated with a higher sanction amount and is always statistically significant. A one million dollar increase in payments is linked to an increase in the resulting sanction of .975 million dollars. So a one point increase in KLD offsets roughly an additional 1.8 million dollars in bribe payments. The amount of value gained from the bribe (Value) also has a positive coefficient, although it is much smaller than that on Payments. Because Value has quite a large standard deviation, the small coefficient still has a large economic effect in explaining sanctions. The relative larger importance of payments suggests that prosecutors consider bribe payments a better signal of harm than the value of business earned.

The other bribe characteristics to consistently and significantly affect sanctions relate to concurrent domestic and foreign investigation. This effect can be interpreted as a reaction to the true harm of a bribe. If the bribe under question is involved in ongoing foreign investigation, the sanction is 20.14 million dollars higher on average, and this is highly significant. This is consistent with the model of optimal fines if foreign involvement is an additional measure of harm. Similarly, bribes in multiple countries receive 7.4 million dollars more in sanctions than those that are narrower in scope. It seems that being involved in multiple ongoing trials and being a repeat offender both lead to a lower sanctions. This is understandable because earlier domestic investigations are almost always linked to the same actions as later ones, so these firms have already been partially punished.

By including both bribe payments, value and many other key bribe characteristics in our regression specification, we believe that we have picked up the heterogeneity in actual harm done by the bribes. This is reinforced by the high R^2 values for these regressions. Our inclusion of year fixed effects ensures that we are not identifying time trends in FCPA sanctions.¹⁵ Therefore, we can reasonably interpret the coefficient on KLD as the effect of firm-specific corporate social responsibility on sanctions, holding fixed the harm of the bribe.

Our baseline results are quite consistent across our three specifications. Figure 2 demonstrates the raw data used to arrive at the relationships in each column. The three sub-figures

¹⁵For all results in the paper, we have run equivalent regressions that also control for a quadratic in the firm's market capitalization, allowing for non-linear effects of market capitalization on fines. Results do not change, suggesting that we are not identifying differences between large and small firms. Firm size is not part of the optimal fines benchmark and we verify that it does not seem to drive fines.

plot the relationship between the sanction assigned to the case and the firm's KLD. Notice that even as more observations are winsorized, sanctions still decline with KLD.

Bribery harm maybe larger when committed in countries less equipped to battle corruption or countries in which the reputation of the US is more important. To control for this possibility, we match in a number of country-specific variables for each country in which a bribe takes place. If the FCPA case covers multiple countries, we take the average over all countries involved. We control for the amount of US foreign direct investment (FDI) into the country in 2004, in millions. Bribery may be more harshly punished if it takes place in countries with valuable ties to the US. We also control for the country's gross national income per capita, in dollars, as well the Worldwide Governance Indicators (WGI) measures for government effectiveness and rule of law. Government effectiveness deals with issues such as the efficiency of the bureaucracy, education, and the extent to which there is trust in the government. The rule of law measure considers issues such as violent crime and property rights. For these four measures, we are able to match the data to these country-level variables for 77 of the 101 cases.

The results of these regressions are displayed in Table 6. Even taking into account country characteristics, it is still true that higher KLD firms are punished less for bribery. In fact the point estimates are slightly larger. For columns (1) and (2), the coefficients on KLD are slightly smaller but similar to those in Table 5. However the point estimate for column (3) increases from -1.736 in Table 5 to -2.298 in Table 6. As this is our preferred specification, we estimate that a one point increase in KLD leads to 2.3 million dollars less in sanctions.

Notice that the coefficients on payments and value remain similar for the most part. In the first two columns, the amount of bribery payments increases sanctions assigned. In the third column, once data is winsorized at the 95% level, the value gained from the bribe becomes a more important predictor of sanctions. The other explanatory variables shown in Table 5 are not displayed but have similar coefficients. On the other hand, the newly added country characteristics are generally not statistically significant.

Up until now, we have treated SEC and DOJ prosecutions of the same crime as different observations. We have also run these regressions while combining the SEC and DOJ sanctions when the firm subsidiary, country, and year are the same. This provides a robustness check

to ensure that our results are not driven by joint decision-making by the DOJ and SEC. Although not shown, the estimates are still generally significant at the 5% level and of similar magnitudes to prior estimates.

To investigate what exactly drives the halo effect in corporate sentencing, we can break KLD down into its components, the six areas in which companies can demonstrate their responsibility. In Table 7 we display the estimates of β_H if we run the main regression using each subcategory of KLD in turn, rather than overall KLD. We include both bribe and country variables, as well as year fixed effects, which are all omitted for brevity. Three of the six categories seem to be consistently significant while one is consistently negative but not statistically significant. These results suggest that the halo effect is mostly generated by responsible behavior towards the community and employees, and by responsible products.

Community KLD, which measures the altruism of the company towards the communities where the firm's operations are located, comes in with the largest point estimates, between -10 and -12 million dollars for all three specifications. These estimates are all significant at the 10% level. The estimated effects of the product KLD score are also large. Product KLD is focused on product quality, the strength of the firm's R&D program, and the provision of products to the economically disadvantaged. The score is lowered by poor product safety, questionable advertising practices, and anti-trust violations. In the three specifications, the coefficients range from -4.7 to -5.1 million dollars. All coefficients are significant at the 5% level.

The next row shows the employee relations score, which is determined by union relations, employee involvement in firm profits (though stock options, etc), the strength of health and safety programs, and the strength of retirement benefits. Across all three specifications, the coefficients on employee KLD are all large and negative, similar in magnitude to the effects for product KLD. In our preferred specification (column (3)) the estimate is statistically significant at the 5% level and suggests that a one point increase in employee KLD decreases sanctions by around 7.1 million dollars.

Turning to the diversity KLD score, we find point estimates are around -1 and none are statistically significant. This category of KLD attempts to capture how well a company promotes diversity and how accepting it is of the needs of its employees. It includes measures

of the promotion of women and minorities, the presence of women and minorities on the board of directors and in businesses with which it contracts, programs enabling work/life balance, employment of the disabled, and tolerant policies towards gays and lesbians. The last two rows show that environment KLD and corporate governance KLD occasionally have positive point estimates and are not statistically significant at any point.

The results in Table 7 makes it clear that our baseline effect, which uses total KLD, averages across these disparate subcategory effects. Earlier we estimated that a one point increase in KLD results in a 2.3 million dollar reduction in sanctions. For the subcategories of community, product, and employee KLD, the effects are always larger. They range from a minimum decrease of 3.5 million dollars to a maximum of 12 million dollars in sanction reduction for a one point increase in one of these three subcategories. Taken all together, these results imply that prosecutors consider a firm's behavior in sentencing, especially towards its community.

5.4 Addressing Reverse Causality

One of the first concerns that accompanies our baseline results is reverse causality. If firms changed their CSR efforts to compensate for bribery allegations, our specification would suffer from an endogeneity problem. A negative correlation between KLD scores and sanctions could be caused by firms with less egregious violations using KLD to overcome the bad publicity. In the first three rows of the Table 8, we address the worry that KLD scores might be driven by FCPA proceedings. To make sure this is not the case, we use KLD lagged by one, two, and three years as the explanatory variable. Each column is defined as in previous tables and each row shows the result of using a different lagged measure of KLD as opposed to the contemporaneous KLD that is the baseline specification explored in Table 6. The regression specifications control for all other bribe characteristics, as well as country variables, recreating the regressions shown in Table 6. In all three cases, the coefficients in column (3) are statistically significant at the 5% level and the effects are similar in magnitude to that of the current KLD score.

To further alleviate the worry that KLD scores might be partially caused by FCPA sanctions, we use KLD scores that predate the stringent enforcement of the FCPA. Even

if firms did not choose KLD directly in response to FCPA sanctions, it could be true that decisions about KLD scores took into account the likelihood of FCPA prosecution. To show that this is not the case, in the last row of Table 8 we exploit the fact that the FCPA only became widely and unexpectedly enforced in 2007. We use as the explanatory variable the KLD score prior to the expansion of FCPA prosecution. In every year prior to 2008 we use that year’s KLD but we use 2007 KLD for all cases prosecuted in or after 2007. Before 2007, very few FCPA cases were prosecuted and there was virtually no concern about the enforcement of the law. The explosion in the caseload right after 2007 is readily seen from Figure 1. Because of this it is unlikely that firms considered FCPA repercussions when deciding their CSR strategy in 2007. Nevertheless, these 2007 KLD scores are still negatively correlated with sanctions and are of similar economic magnitudes to our base specification. The estimate from our preferred specification in column (3) is again significant at the 5% level.

The tests above demonstrate that prosecutorial decisions are driven by KLD scores, rather than vice versa. We use pre-2007 KLD scores to show that our results are not driven by the joint determination of bribery violations and KLD after the FCPA became widely enforced.

5.5 Accounting for Compliance or Cooperation

Having shown that KLD scores affect sanctions above and beyond what is warranted by bribe characteristics, we move on to show that this also exceeds the optimal fines driven by cooperation. In corporate criminal cases it is optimal for prosecutors to tie the sanction amount to the cooperation and compliance of the firm (Arlen, 1994; Arlen and Kraakman, 1997). So it is important to verify that any relationship between KLD and sanctions is not driven by more socially responsible firms being more cooperative with prosecution.¹⁶

In order to study this effect, we use the press releases by the DOJ and SEC that accompany the settlement of every FCPA case. Following Choi and Davis (2013), we use text-mining to score the press releases by the frequency of words like “cooperation” or “compliance”. More specifically, we take all the press releases associated with our cases and create

¹⁶Compliance with prosecution is especially important to control for because it may also alter the probability of detection in each firm.

a list of all the words (nouns, verbs, adjectives and adverbs) and the frequency of their occurrence. We then take only the words which occur at least 150 times, for a total 377 words. We assign each word a score of 2, 1, 0, -1, or -2. Words that reflect cooperation or compliance get a score of 2. Words that reflect non-cooperation or non-compliance get a score of -2. For instance, the word “compliance” occurs 1632 times and gets a score of 2. The word “cooperation”, which occurs 266 times, also gets a score of 2. In contrast, the words “guilty” and “offense” get a score of -2. We then sum these scores to get a Collaboration Score for each case.

The mean collaboration score is -18.9 and the median is -17.5. However, there is a significant standard deviation of 16.2. In Table 9, we re-run our baseline regression of sanctions on KLD (from Table 6) but now also control for the Collaboration Score. Our baseline results are largely unchanged. To further demonstrate the divergence between KLD and cooperation, in column (1) of Table 10 we directly test the relationship between the two. Higher KLD scores do not lead to a significantly higher collaboration score. This analysis serves to rule out heterogeneity in collaboration as the channel through which high KLD firms have lower sanctions.

5.6 Prosecutorial Bias: Incentives or Halo?

We have established a bias in sanctions, a deviation from the optimal benchmark where unbiased prosecutors set fines taking into account only bribe characteristics and cooperation. But this prosecutorial bias need not be due to the psychological and expectational bias of the halo effect. It could instead be due to biased incentives or conflicts of interest, where the prosecutors may take into account the political sway of firms to avoid angering those that are more powerful (Johnson, 1973).¹⁷

If existent, this political bias could manifest itself in two different ways. The first is that more liberal firms, those more likely to be associated with the Democratic party, tend to be more socially responsible (Giuli and Kostovetsky, 2014). If prosecutors from the DOJ and

¹⁷One might also worry that prosecutors are intentionally assigning lower sanctions to firms if their revenue is more likely to go to charitable purposes. However, considering the difference in sanctions is on the order of a few million dollars, it is unlikely that this contributes significantly to corporate social responsibility. A large part of the cost of being subject to an FCPA investigation is the legal fees.

SEC favor Democrats, this affiliation could lead to lower fines. This would be plausible if the prosecutors were indeed liberal. However, it is important to note that the explosion in FCPA enforcement was driven not by Democrats, but by Republicans. Prosecutions picked up sharply in 2007, under the leadership of appointees of George W. Bush. Leading the charge were a Republican deputy attorney general, assistant attorney general, and new assistant chief of the DOJ's Fraud Section, who is known as a conservative pundit.¹⁸ Therefore it would seem that political favoritism is not responsible for the beneficial treatment of more socially responsible firms.¹⁹

The other way in which political bias might influence the assignment of FCPA fines is if more socially responsible firms are more politically active in general, and this affects the career concerns of prosecutors. Then KLD may capture the effect of political clout rather than CSR. This could also be driven to firm size, which has been shown to be closely related to KLD scores. Larger firms may have more political sway. To account for size, we control for a quadratic in market capitalization. In order to further address the issue of political power, we collect data on firm's donations to politicians and elections. The Federal Election Commission records contributions from all individuals and firms of at least \$200, as long as they are not made through a Political Action Committee. This provides a measure of how politically active each company is.

Donations allow us to construct two measures of political influence. Lagged donations, those between ten and five years before the FCPA action, capture historical political involvement. These contributions precede FCPA action and therefore are unlikely to be related to recent charges. Recent donations, those beginning five years before the FCPA action, potentially reflect responses to prosecution. This would pick up increases in political contributions meant to sway prosecutors during the time the fine is determined. The median firm in the sample does not have any documented contributions in any of these years. However, the mean amount of lagged donations is \$103,000, with a standard deviation of \$211,000. The mean contribution for the five years preceding the FCPA action is \$50,000, with a standard devia-

¹⁸The rise of FCPA enforcement under this leadership is described by the law firm Gibson, Dunn & Crutcher LLP: <http://www.gibsondunn.com/publications/pages/FCPAEnforcementExplosionContinues.aspx>

¹⁹If political considerations were key, we might also expect to see differential treatment of more socially responsible firms under Democratic and Republican administrations. Instead, we found that the effect of KLD on sanctions does not differ systematically with the party in power.

tion of \$226,000. These numbers reflect the wide dispersion of political involvement amongst prosecuted firms. It seems that involvement in FCPA actions causes firms to dampen their political contributions rather than increase them, perhaps to avoid political scrutiny during the investigation.

First we investigate the relationship between political donation and corporate social responsibility. Table 11 shows how political donations vary with KLD, after controlling for year fixed effects. The first column focuses on lagged donations, those from 10 to 5 years before the resolution of the FCPA action. The second column focuses on recent donations, during the 5 years prior to the FCPA action. In both cases, donations are actually negatively related to KLD scores, although this is not statistically significant. The more socially responsible firms are historically less politically active. The dependent variable is measured in millions of dollars, so a one-point increase in KLD is associated with \$12,000 less in donations. This suggests that rather than going hand in hand, political activity is either orthogonal to CSR or may be an alternate route to achieving influence. This casts doubt on the idea of political donations as a driver of sanction outcomes.

However, we can further verify that political donations are not likely to influence sanctions. We directly test the relationship between donations and FCPA fines in Table 12. These regressions revisit the baseline specification for the effects of KLD on sanctions but also control for the amount of recent political donations by the company, as well as a quadratic in firm market capitalization. The main takeaway from this table is that the effects of KLD remains the same as before. One extra point of KLD is associated with a 2.5 million dollar reduction in sanctions, and this result is statistically significant at the 5% level. Meanwhile, the coefficients on donations are never significant. Likewise, the coefficients on market capitalization are not significant. A qualitatively similar pattern emerges when using lagged donations, rather than recent donations. Therefore it is not true that the link between KLD and sanctions is driven by political considerations.

Having ruled out an incentives bias story for our findings, it would be helpful to get some additional evidence that the deviation is connected to a halo effect. To this end, we use the two leading text mining algorithms, LIWC and SentiWordNet, to measure the positive emotional or sentimental content of the press releases. There is a long history in psychology

and linguistics of inferring emotional or mental states from written passages.²⁰ One benefit of these two algorithms is that the dictionaries for LIWC and SentiWordnet are obtained using training samples from the broader population rather than legal documents.²¹ In other words, while we focused on words associated with cooperation or non-cooperation when building the dictionary for our Collaboration score, the dictionaries for LIWC and SentiWordNet are built to pick up broader sentiment. For the 'SentiWordNet' method, we scan press releases, extract words from them, and then sum up the scores for all words to produce a score for the whole passage.²² For the 'LIWC' method, we similarly generate the score by using software from LIWC.²³

The positive emotion measures are similar to those found in the broader population of non-legal text documents. The Positive Emotion score from the LIWC has a mean of 2.58 and a median of 2.44. The standard deviation of the score is .711. The Senti Score from SentiWordNet has a mean of 2.17 and median of 1.98 with a larger standard deviation of 1.73. Although a negative emotion score is also available, we have focused on positive emotion in order to measure the halo effect.²⁴

In columns (2) and (3) of Table 10, we find that higher KLD firms are more likely to have positive sentiment in their press releases, as measure by the Senti score. For the Positive Emotion score from LIWC in column (2), the coefficient on KLD is .073 with a T-statistic of 1.59. For the Senti score in column (3), the coefficient is .222 and it is significant at the 10% level. In other words, it appears that the lower sanctions obtained by high KLD firms are reflected in the emotional or sentimental tones in these press releases, consistent with the halo effect.

²⁰see Christopher Potts' website for a tutorial <http://sentiment.christopherpotts.net/>

²¹Another popular algorithm, named General Inquirer from Harvard University, is widely used in classifying sentiment from financial media (see, e.g., Tetlock (2007)), which generally tends to yield results very similar to LIWC.

²²The official website is <http://sentiwordnet.isti.cnr.it> and the documentation of SentiwordNet 3.0 is <http://nmis.isti.cnr.it/sebastiani/Publications/LREC10.pdf>

²³The software is available on its official website at <http://www.liwc.net> and a description is available at <http://www.liwc.net/howliwcworks.php>.

²⁴The negative emotion scores generated are typically far lower than what is reported for non-legal texts. It appears that these legal documents avoid using negative sentiments and so there is not much variation across cases. Fortunately, psychology studies of the halo effect have also emphasized positive emotions.

5.7 Selection of Cases

Our study has focused exclusively on fines levied in FCPA cases. We take the FCPA cases as given and establish a halo effect in sentencing relative to the benchmark of optimal fines along the lines of Becker (1974b) and Polinsky and Shavell (1992). There may also be a halo effect in the selection of cases to prosecute, since prosecutors have discretion in that domain as well.

In Table 13 we examine whether firm KLD scores are correlated with the probability of ending up in our FCPA sample. The regression estimates a linear probability model using all firms with a KLD score, and controls for an indicator for whether the firm is a US company and for year and industry fixed effects. Column (2) also controls for a quadratic in firm market capitalization. The coefficient on KLD is consistent across the two specifications, implying that a one point increase in KLD decreases the likelihood of ending up in the FCPA sample by 0.04 percentage points. In column (2) this is significant at the 10% level but it is still an economically small effect.

Because we cannot observe actual bribery, we do not know if this decreased likelihood of FCPA prosecution is due to lower incidence of bribery in higher KLD firms or if it is due to a halo effect in prosecution. However, there is evidence to suggest that bribery is extremely common across many different types of firms, lending credence to the possibility that the halo effect is at play. The realization that bribery was widespread is what drove the passage of the FCPA. Zeume (2014) finds that foreign firms that operate in high-corruption areas experienced negative returns following the passage of an anti-bribery act, suggesting that many firms operating in certain regions engage in some level of bribery. Such evidence casts bribery as a cost of business rather than a practice undertaken by a minority of firms. Although we cannot make any definitive statements about selection into the FCPA without more data on the pool of offenders, it is possible that all else equal, prosecutors are less willing to prosecute more socially responsible firms.

6 Conclusion

Corporate social responsibility is becoming an ever more important part of corporate strategy. As a result it is increasingly important to understand what motivates CSR and how it can benefit companies. The three leading theories of strategic corporate social responsibility all identify corporate image as a key factor but isolating these empirically has been a challenge. This task is made all the more difficult by the fact that consumers value all three effects.

We are able to isolate the halo effect by focusing on federal prosecutors, who do not consume company products and are therefore not susceptible to product signalling or delegated giving. We study their punishment of crimes by socially responsible corporations. Using data on the prosecution of the Foreign Corrupt Practices Act (FCPA) by the US Department of Justice and the SEC, we find that firms with higher social responsibility scores, as measured by KLD scores pay \$2 million dollars or 40% less than the median fine for bribing foreign officials relative to the optimal fines benchmark following Becker (1974b).

Due to our limited sample size, we focus our efforts in showing that our results are robust to outliers and alternative explanations. We argue that KLD is not chosen strategically in response to FCPA fines by showing that previous KLD can predict fines and that bribe characteristics such as compliance do not change with KLD. Given the high R^2 of our regressions, we believe it is likely that we have accounted for much of the heterogeneity in bribes. We also find evidence in support of the halo effect by using textual analysis of FCPA press releases and cast doubt on the role of prosecutorial conflict of interest by using data on firm campaign donations. Overall our results are economically and statistically robust, strengthening the evidence for a halo effect in the punishment of corporate crime.

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Figure 1: FCPA Actions by Year

Note: All FCPA actions are show by the year in which the case was filed.

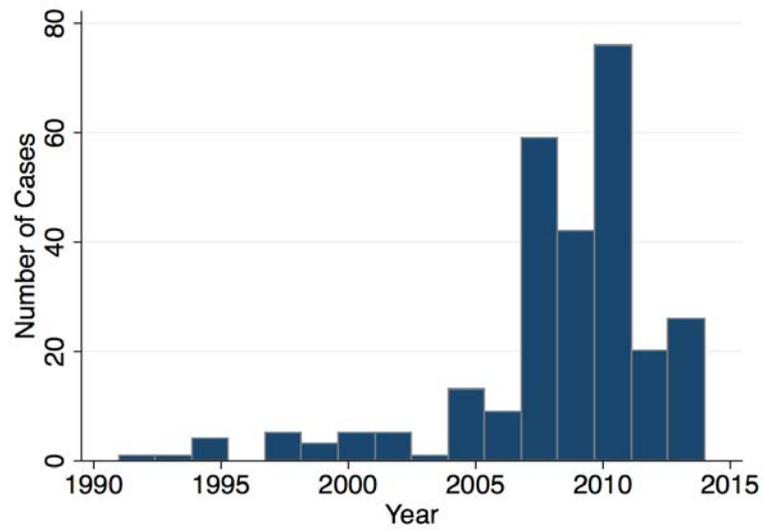


Figure 2: Sanctions by KLD

Note: The figures show the raw relationship between the sanction amount and KLD. Sub-figure (a) includes all observations. In sub-figure (b) the sanction amount is winsorized at 2.5% and 97.5%. In sub-figure (3) the sanction amount is winsorized at 95%.

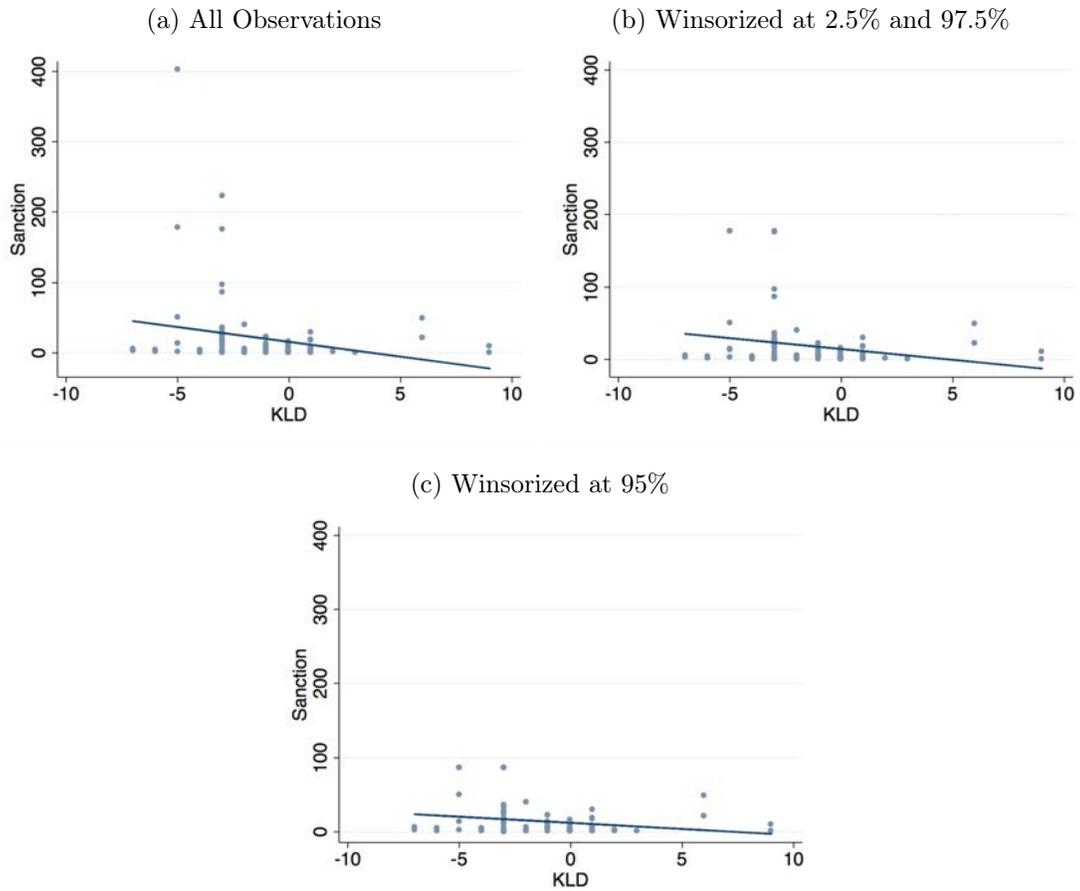


Table 1: Summary Statistics

Note: Summary statistics are shown for the 101 FCPA cases that match to KLD data. Market capitalization, sanction, payments, and value are measured in millions of dollars.

	Mean	Median	StDev
Market Cap (millions)	27,863	5,725	55,342
KLD	-1.06	-1	2.83
US Company	.871	1	.337
Sanction (millions)	20.3	5.23	51.9
Payments (millions)	9.26	2	27.2
Value (millions)	300	98.2	892
# Years Bribery	5.78	5	3.21
Related Party Involved	.515	1	.502
Foreign Investigation Ongoing	.149	0	.357
Multiple Countries	.396	0	.492
Multiple Ongoing Trials	.802	1	.4
Repeat Offense	.0693	0	.255

Table 2: Cases by Industry

Note: Industries are shown for the 101 FCPA cases that match to KLD data. Industries are defined as the 17 Fama-French industry portfolios.

Food	10
Oil	13
Apparel	2
Chemicals	3
Consumer Goods	9
Construction	3
Steel	2
Fabricated Products	2
Machinery	19
Transportation	5
Utilities	2
Other	31
Total	101

Table 3: Cases by Country

Note: The country in which bribery occurred is shown for the 101 FCPA cases that match to KLD data. For brevity, we only display the countries for which there are more than 3 FCPA cases. The number of observations is greater than 101 because each FCPA case can involve multiple countries.

Angola	4
Argentina	8
Bahrain	4
Brazil	5
China	28
Croatia	4
Egypt	6
Greece	7
India	10
Indonesia	12
Iraq	20
Kazakhstan	4
Mexico	5
Nigeria	9
Poland	6
Russia	6
Saudi Arabia	4
South Korea	4
Thailand	9
Turkey	4
United Arab Emirates	7
Venezuela	4
Total	170

Table 4: The Effect of CSR on Bribe Characteristics

Note: The regressions includes all observations and the dependent variables cover all observable bribe characteristics. All regressions include year fixed effects. Payments and value are measured in millions of dollars. In the first table, columns (1) and (3) include all observations while columns (2) and (4) are winsorized at 95%. Standard errors are robust and clustered at firm level. * $p < .05$, + $p < .10$

	(1) Payments	(2) Payments	(3) Value	(4) Value
KLD	-2.994 (-1.53)	-0.291 (-0.98)	-73.115 (-1.06)	-1.062 (-0.13)
Year FE	Yes	Yes	Yes	Yes
Observations	101	101	101	101
R^2	0.263	0.184	0.167	0.114

	Multiple Countries	Years of Bribery	Subsidiary	Related Party
KLD	0.028 (1.45)	0.183 (1.19)	0.016 (0.67)	-0.059* (-2.40)
Year FE	Yes	Yes	Yes	Yes
Observations	101	101	101	101
R^2	0.213	0.263	0.329	0.249

	Repeat Offense	Foreign Investigation	Multiple Trials	DOJ
KLD	-0.003 (-0.19)	0.039* (2.03)	-0.028 (-1.63)	-0.013 (-0.84)
Year FE	Yes	Yes	Yes	Yes
Observations	101	101	101	101
R^2	0.287	0.247	0.262	0.034

	US FDI	Country GNI	Rule of Law	Govt Effectiveness
KLD	-920.432 (-0.65)	355.473+ (1.74)	0.083* (4.15)	0.067* (2.41)
Year FE	Yes	Yes	Yes	Yes
Observations	82	92	97	97
R^2	0.215	0.468	0.453	0.488

Table 5: Effect of CSR on Sanctions

Note: The dependent variable in all regressions is the sanction assigned by the prosecutor. All regressions include year fixed effects, an indicator for DOJ cases, an indicator for US companies, and indicators for whether payments or value are missing. Sanction, payments, and value are measured in millions of dollars. Column (1) includes all observations. In column (2), sanction, value, and payments are winsorized at 2.5% and 97.5%. In column (3), these variables are winsorized at 95%. Standard errors are robust and clustered at firm level. * $p < .05$, + $p < .10$

	(1)	(2)	(3)
	Sanction	Sanction	Sanction
KLD	-1.818* (-2.49)	-1.863* (-2.99)	-1.736* (-2.86)
Payments	0.879+ (1.68)	0.836* (2.67)	0.975* (2.07)
Value	0.018 (1.36)	0.015 (1.61)	0.039+ (1.94)
Related Party Involved	0.389 (0.12)	2.058 (0.82)	1.565 (0.63)
Foreign Investigation Ongoing	21.242* (3.10)	20.989* (3.80)	20.141* (4.02)
Number of Years of Bribery	-1.337 (-0.90)	-0.624 (-0.64)	0.739 (1.06)
Multiple Countries	15.379* (3.03)	13.238* (2.99)	7.445+ (1.77)
Multiple Ongoing Trials	-9.730+ (-1.93)	-6.022+ (-1.77)	-6.222+ (-1.82)
Repeat Offense	-15.675* (-2.23)	-15.084* (-2.32)	-13.040* (-2.18)
Year FE	Yes	Yes	Yes
Observations	101	101	101
R^2	0.825	0.866	0.714

Table 6: Effect of CSR on Sanctions, With Country Variables

Note: The dependent variable in all regressions is the sanction assigned by the prosecutor. All regressions include year fixed effects, an indicator for DOJ cases, an indicator for US companies, and indicators for whether payments or value are missing. Also omitted for brevity but included in the regression are all variables shown in Table 5. Sanction, payments, and value are measured in millions of dollars. Column (1) includes all observations. In column (2), sanction, value, and payments are winsorized at 2.5% and 97.5%. In column (3), these variables are winsorized at 95%. Standard errors are robust and clustered at firm level.
 * $p < .05$, + $p < .10$

	(1)	(2)	(3)
	Sanction	Sanction	Sanction
KLD	-1.649 ⁺ (-1.69)	-1.715* (-2.13)	-2.298* (-3.89)
Payments	1.076 ⁺ (1.87)	0.852* (2.28)	-0.040 (-0.08)
Value	0.010 (1.20)	0.010 ⁺ (1.69)	0.063* (3.88)
US FDI to Country	-0.000 (-0.63)	-0.000 (-0.91)	-0.000 (-1.24)
Government GNI	0.001 (1.58)	0.001 ⁺ (1.98)	0.000 (0.93)
Government Rule of Law	-0.291 (-0.02)	-5.768 (-0.48)	-5.613 (-0.53)
Government Effectiveness	-25.202 (-1.54)	-22.134 (-1.60)	-14.060 (-1.19)
Observations	77	77	77
R^2	0.825	0.872	0.752

Table 7: Effect of CSR Subcategories on Sanctions

Note: The dependent variable in all regressions is the sanction assigned by the prosecutor. The regression specifications are the same as in Table 6 but differ in the variable used for *KLD*. Each row represents a separate regression, where KLD is measured by using a different subcategory. There are 77 observations in each regression. For brevity, only the coefficients on KLD are displayed. Column (1) includes all observations. In column (2), sanction, value, and payments are winsorized at 2.5% and 97.5%. In column (3), these variables are winsorized at 95%. Standard errors are robust and clustered at firm level. * $p < .05$, + $p < .10$

	(1)	(2)	(3)
	Sanction	Sanction	Sanction
Community KLD	-11.990 ⁺ (-1.84)	-11.165 ⁺ (-1.98)	-10.487* (-2.29)
Product KLD	-5.013* (-2.62)	-4.676* (-2.73)	-5.139* (-2.83)
Employee KLD	-3.527 (-1.38)	-3.770 ⁺ (-1.73)	-7.124* (-3.28)
Diversity KLD	-1.158 (-0.54)	-1.023 (-0.64)	-0.771 (-0.61)
Environment KLD	3.735 (1.10)	2.210 (0.78)	-3.229 (-1.33)
Corp Gov KLD	1.265 (0.26)	1.925 (0.44)	-0.757 (-0.19)

Table 8: Effect of Prior CSR on Sanctions

Note: The dependent variable in all regressions is the sanction assigned by the prosecutor. The regression specifications are the same as in Table 6 but differ in the variable used for KLD. For brevity, only the coefficients on KLD are displayed. KLD $t - n$ is the KLD score lagged n years. KLD 2007 is the KLD score in year 2007, or the year of the case if it preceded 2006. There are 75 observations in the regression using KLD t-1, 72 for KLD t-2, 67 for KLD t-3, and 71 for 2007 KLD. Column (1) includes all observations. In column (2), sanction, value, and payments are winsorized at 2.5% and 97.5%. In column (3), these variables are winsorized at 95%. Standard errors are robust and clustered at firm level. * $p < .05$, + $p < .10$

	(1)	(2)	(3)
	Sanction	Sanction	Sanction
KLD t-1	-1.496 (-1.49)	-1.616 ⁺ (-2.00)	-2.188* (-4.00)
KLD t-2	-0.971 (-0.74)	-1.396 (-1.30)	-1.835* (-2.69)
KLD t-3	-1.520 (-1.07)	-1.964 ⁺ (-1.75)	-2.330* (-2.90)
2007 KLD	-1.490 ⁺ (-1.71)	-1.342 ⁺ (-1.85)	-2.107* (-4.02)

Table 9: Effect of CSR on Sanctions, with Collaboration Score

Note: The dependent variable in all regressions is the sanction assigned by the prosecutor. The regression specifications are the same as those in Table 6 but include an additional explanatory variable: the collaboration score of the text. The score is calculated by text-mining the DOJ or SEC press release for each case. Sanction, payments, and value are in millions of dollars. Column (1) includes all observations. In column (2), sanction, value, and payments are winsorized at 2.5% and 97.5%. In column (3), these variables are winsorized at 95%. Standard errors are robust and clustered at firm level. * $p < .05$, + $p < .10$

	(1)	(2)	(3)
	Sanction	Sanction	Sanction
KLD	-1.921 (-1.35)	-2.123 ⁺ (-1.80)	-2.401* (-2.85)
Collaboration Score	0.212 (0.89)	0.103 (0.60)	0.239 (1.66)
Payments	1.066 ⁺ (1.75)	0.855* (2.11)	-0.098 (-0.20)
Value	0.009 (1.04)	0.010 (1.63)	0.060* (3.91)
Number of Years of Bribery	1.224 (0.83)	0.954 (0.85)	1.953 ⁺ (1.87)
Related Party Involved	-1.655 (-0.20)	-3.294 (-0.61)	3.022 (0.70)
Foreign Investigation Ongoing	19.827 ⁺ (1.82)	21.092* (2.33)	26.415* (4.36)
Multiple Ongoing Trials	-22.940* (-2.15)	-15.917* (-2.29)	-15.231* (-2.52)
Multiple Countries	7.911 (0.72)	4.835 (0.52)	5.342 (0.76)
Repeat Offense	-23.112 (-1.28)	-17.541 (-1.13)	-24.712 ⁺ (-1.71)
Year FE	Yes	Yes	Yes
Observations	69	69	69
R^2	0.827	0.879	0.767

Table 10: Effect of CSR on Press Releases

Note: The dependent variables in all regressions are the three different scores of the FCPA press releases. Each score is calculated by text-mining the DOJ or SEC press release for each case. The explanatory variables are the same as those in Table 6. Sanction, payments, and value are measured in millions of dollars. Standard errors are robust and clustered at firm level. * $p < .05$, + $p < .10$

	(1) Collaboration Score	(2) LIWC Score	(3) Senti Score
KLD	0.165 (0.16)	0.070 ⁺ (1.74)	0.280* (2.36)
Payments	0.208 (1.31)	-0.000 (-0.03)	0.022 (1.26)
Value	0.000 (0.17)	0.000 (0.58)	-0.000 (-1.22)
Number of Years of Bribery	-1.991 ⁺ (-1.86)	-0.036 (-0.50)	0.010 (0.08)
Related Party Involved	-23.659* (-4.55)	0.198 (0.66)	-0.404 (-0.78)
Foreign Investigation Ongoing	-17.314 ⁺ (-1.84)	0.049 (0.09)	-1.816* (-2.17)
Multiple Ongoing Trials	11.034 (1.53)	-0.058 (-0.16)	1.876* (2.32)
Multiple Countries	-6.149 (-0.94)	0.644 ⁺ (1.78)	0.404 (0.55)
Repeat Offense	35.949* (3.08)	-0.166 (-0.32)	1.633 ⁺ (1.79)
Year FE	Yes	Yes	Yes
Observations	69	75	69
R^2	0.737	0.498	0.709

Table 11: Effect of CSR on Donations

Note: The dependent variable in both regressions is political donations, in millions of dollars. The first column measures all donations from ten years before the FCPA action up until 5 years before the action. the second column measures all donations starting from five years before the FCPA action. Both regressions control for year fixed effects. Standard errors are robust and clustered at firm level. * $p < .05$, + $p < .10$

	Donations 10 to 5 Years Prior	Donations 5 Years Prior
KLD	-0.013 (-1.10)	-0.012 (-1.63)
Year FE	Yes	Yes
Observations	100	100
R^2	0.282	0.685

Table 12: Effect of CSR on Sanctions, with Recent Donations

Note: The dependent variable in all regressions is the sanction assigned by the prosecutor. The regression specifications are the same as those in Table 6 but include two additional explanatory variable: political donations and a quadratic in market capitalization. The donations measure includes all donations in the five years leading up to the FCPA action. Donations, market capitalization, sanction, payments, and value are in millions of dollars. Column (1) includes all observations. In column (2), sanction, value, and payments are winsorized at 2.5% and 97.5%. In column (3), these variables are winsorized at 95%. Standard errors are robust and clustered at firm level. * $p < .05$, + $p < .10$

	(1)	(2)	(3)
	Sanction	Sanction	Sanction
KLD	-2.654 (-1.64)	-2.426 ⁺ (-1.86)	-2.468* (-2.59)
Donations 5 Years Prior	7.219 (0.50)	-1.851 (-0.18)	-0.060 (-0.01)
Payments	1.082 ⁺ (1.80)	0.851* (2.23)	-0.168 (-0.38)
Value	0.010 (1.12)	0.011 (1.56)	0.058* (3.63)
Market Cap	-0.000 (-0.75)	-0.000 (-0.42)	0.000 (0.45)
Market Cap [^] 2	0.000 (0.96)	0.000 (0.65)	-0.000 (-0.14)
Number of Years of Bribery	1.900 (1.32)	1.652 (1.33)	2.165 ⁺ (1.84)
Related Party Involved	-10.496 (-1.19)	-8.170 (-1.19)	-2.085 (-0.41)
Foreign Investigation Ongoing	4.604 (0.43)	9.829 (1.13)	17.878* (2.53)
Multiple Ongoing Trials	-20.134* (-2.05)	-13.572* (-2.01)	-8.661 (-1.56)
Multiple Countries	2.205 (0.22)	0.269 (0.03)	0.663 (0.11)
Repeat Offense	-18.378 (-1.32)	-14.547 (-1.18)	-18.137 (-1.57)
Year FE	Yes	Yes	Yes
Observations	77	77	77
R^2	0.830	0.880	0.767

Table 13: The Effect of CSR on Probability of FCPA Offense

Note: The dependent variable is an indicator for whether a company was caught in violation of the FCPA. The regression uses all firms with a known KLD score. We estimate a linear regression model which controls for year and industry fixed effects. The first column controls for whether the company is in the US while the second column also controls for a quadratic in market capitalization, measured in in millions of dollars. Standard errors are clustered at the firm level. * $p < .05$, + $p < .10$

	(1)	(2)
	FCPA Offender	FCPA Offender
KLD	-0.0004 (-1.46)	-0.0004 ⁺ (-1.78)
US Company	-0.0039 (-1.51)	-0.0036 (-1.42)
Market Cap		0.0000* (3.73)
Market Cap \wedge 2		-0.0000* (-3.29)
Year FE	Yes	Yes
Industry FE	Yes	Yes
Observations	40560	40473
R^2	0.003	0.006