Institutional Investor Distraction and Unethical Business Practices: Evidence from Stakeholder-Related Misconduct

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Abstract

We exploit exogenous shocks to institutional investor portfolios to show that managers engage in significantly more stakeholder-related misconduct when institutional investors are distracted. This relationship is more pronounced for firms where managers are more enticed to commit wrongdoing or have more outside options in the executive labor market, and for firms with weak internal and external governance. Overall, our evidence suggests institutional investors are important monitors of management and prevent misconduct detrimental to both shareholders and stakeholders.

Keywords: corporate governance, institutional investors, misconduct, monitoring, distraction, stakeholder

JEL classification: G3, G30, G34, G41

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1 Introduction

There is a large body of literature highlighting that institutional investors play an important role in shaping the governance of their portfolio firms and act as effective monitors (see e.g., Aggarwal et al., 2011; Brav et al., 2008; Bricker and Markarian, 2015; Gillan and Starks, 2003; Kang et al., 2018; McCahery et al., 2016). However, institutional investor attention is limited (see e.g., DellaVigna and Pollet, 2009; Hirshleifer and Teoh, 2003; Hirshleifer et al., 2009, 2011; Peng and Xiong, 2006).[1] This implies institutional investors are unable to simultaneously monitor all the firms in their portfolios with the same intensity (Kempf et al., 2017). When there is a shock or another attention-grabbing event happens in an industry that is important to their portfolios, they have to shift their (limited) attention towards firms in this industry while neglecting firms in other industries. Therefore, at certain points in time, institutional investors monitor some firms in their portfolios less effectively.

Previous studies have shown that during these periods of *institutional distraction*, managers are more likely to maximize their private benefits and engage in value-destroying acquisitions (Kempf et al., 2017). They are also more likely to manage earnings (Garel et al., 2021) and change their general disclosure choices (see e.g., Abramova et al., 2020; DeHaan et al., 2015; Ni et al., 2020). Furthermore, Li et al. (2021) show that institutional distraction affects managers' tax planning decisions, while Liu et al. (2020) stress that it has an impact on board monitoring incentives as well.

In this study, we examine whether managers are also more likely to engage in significantly more (stakeholder-related) misconduct when they face less institutional monitoring. The rationale behind this is that misconduct can ultimately be seen as a "risky"

[1]Most of the studies show that the underreaction to news is the result of limited investor attention.

project that managers may consider in order to boost firm profitability and, more importantly, their own wealth (Chircop et al., 2022). However, institutional investors, who usually hold a significant proportion of the firm's shares, would likely question whether managers should undertake such projects. Therefore, to avoid conflicts, managers may specifically exploit periods of institutional distraction to commit misconduct.

To investigate this, we construct measures of corporate misconduct based on the Violation Tracker database and a measure of institutional distraction following Kempf et al. (2017). This approach has two distinctive advantages. First, employing measures of misconduct based on the Violation Tracker database has the advantage that this database covers a wide range of different corporate violations (e.g., environmental violations, consumer-protection violations, workplace safety violations, securities law violations, etc.). So we do not focus primarily on management actions that are detrimental to shareholders, but rather on those that are detrimental to various stakeholders. And second, employing the measure of institutional distraction from Kempf et al. (2017) has the advantage of allowing for clear identification of the effect of institutional distraction on corporate misconduct. This is because their firm-level measure of distraction exploits exogenous shocks to industries, which are unrelated to a given firm's industry but are important to certain institutional investors' portfolios. Hence, this measure allows us to identify periods where these institutional investors may shift their attention away from the focal firm and rather focus on those portfolio firms subject to the shock.

Using a sample of 9,887 firm-year observations of US public firms in the period from 2000 through 2017, we find that managers commit significantly more stakeholder-related misconduct during periods when institutional investors are distracted. This is consistent with the *Distracted Shareholder Hypothesis* in Kempf et al. (2017), which states that the

looser monitoring constraints during periods of institutional distraction make it easier for managers to maximize private benefits – or in our setting, to commit wrongdoing. In terms of economic magnitude, our baseline estimates suggest that a one standard deviation increase in institutional distraction is associated with a 5.1% increase in the number of violations and with a 30.7% increase in penalties.

To ensure robustness of these results, we carry out several other tests. For instance, we rerun our regressions using alternative dependent and independent variables as well as different estimators, which may be more appropriate in our setting. Furthermore, we conduct a first-difference analysis that allows us to rule out that any unobservable time-invariant firm heterogeneity is driving our results. Considering that we find results consistent with our baseline results in all of these tests, and that the distraction measure we use is by construction exogenous, we believe that the documented association between institutional distraction and corporate misconduct is likely causal.

To identify the potential mechanisms driving our results, we next test for cross-sectional heterogeneity. First, we test whether the effect is stronger when CEOs have strong incentives to commit wrongdoing or when they have more outside options in the executive labor market. The rationale behind this is that CEOs with stronger incentives and more outside options might be more willing to exploit periods of institutional distraction since their potential benefits may outweigh the disadvantages. To test this, we split the sample based on seven proxies: (I) the General Ability Index (*GAI*) developed by Custódio et al. (2013), (II) the Managerial Ability Score (*MA Score*) developed by Demerjian et al. (2012), (III) the CEO's tenure with firm, (IV) the CEO's age, (V) the CEO founder status, (VI) the proportion of the firm's shares held by the CEO, and (VII) the ratio of CEO vega to CEO delta. Consistent with prior literature (see e.g., Custódio

et al., 2019; Fee et al., 2018), we argue that CEOs who are younger, have less tenure or have more (general) managerial abilities have more outside options in the executive labor market and might therefore be more enticed to commit wrongdoing. Similarly, we expect that CEOs holding only a small proportion of the firm's shares or having a higher ratio of vega to delta are more likely to commit wrongdoing (Nguyen et al., 2016). As the results from our sample splits strongly support these conjectures, we conclude that this is an important mechanism explaining the documented association between institutional distraction and corporate misconduct.

Next, we investigate whether there is cross-sectional heterogeneity depending on the strength of internal monitoring. The reason is that it might be easier for CEOs to exploit periods of institutional distraction at firms with weaker internal monitoring, as there is no compensation for the lack of institutional monitoring. We explore this by splitting the sample based on three common proxies: (I) the Gompers et al. (2003) (GIM) index, (II) the board size, and (III) the proportion of independent directors on the board. In line with previous literature (see e.g., Garel et al., 2021; Ni et al., 2020), we expect the effect to be stronger for firms with higher GIM index values[2], larger boards, and a lower proportion of independent directors. Our results largely support this and suggest that weak internal monitoring mechanisms make it easier for managers to exploit periods of institutional distraction to commit wrongdoing.

Finally, we test for cross-sectional heterogeneity depending on the strength of external monitoring since weak external monitoring might also make it easier for CEOs to exploit periods of institutional distraction. To do this, we rerun our baseline regressions on subsamples of firms with high and low analyst coverage as well as on subsamples of

[2]Higher values are associated with weaker governance.

firms with high and low institutional investor attention.[3] We find that the documented association between institutional distraction and corporate misconduct is stronger for firms with weaker external monitoring, which is consistent with previous literature and our expectations (see e.g., Chen et al., 2015; Garel et al., 2021).

Apart from the tests for cross-sectional heterogeneity, we also perform additional tests that help us to further unravel the relationship between institutional distraction and corporate misconduct. In these tests, we exploit the feature of the Violation Tracker database of covering a variety of different violations. The results suggest that managers engage in misconduct related to a variety of different offense groups during periods of institutional distraction. Further, consistent with our previous findings, the results are more pronounced when managers have more outside options and stronger equity incentives.

Our study contributes to the literature in at least two ways. First, we contribute to the literature mentioned above, which examines how institutional distraction affects corporate actions. While previous studies have shown that managers exploit these periods of distraction for their personal benefits and change their disclosure strategies, we provide evidence that they also engage in significantly more corporate misconduct during these periods. Our results further suggest that managers appear to weigh the potential benefits and disadvantages before exploiting periods of institutional distraction. To the best of our knowledge, these findings are new; and we also note that our setting strongly mitigates endogeneity concerns.

Second, our study contributes to the literature by documenting the monitoring role of institutional investors on violations that are not only detrimental to shareholders but also to various stakeholders. This is an important feature of the data from the Violation

[3]We measure institutional investor attention using a proxy constructed on the basis of Electronic Data Gathering, Analysis, and Retrieval (EDGAR) searches.

Tracker database used in our tests. We believe that this finding is important and extends the literature, which shows that institutional investors put emphasis on corporate social responsibility (see e.g., Chen et al., 2020; Dimson et al., 2015; Dyck et al., 2019).

We structure the remainder of this paper as follows. In Section 2, we provide the theoretical background and develop our hypotheses. In Section 3, we describe the sample construction and the main variables. In Section 4, we present the results from the empirical analysis. Finally, in Section 5, we provide a brief discussion and conclusion.

2 Theoretical Background, Related Literature, and Hypotheses

Since Kahneman (1973), there have been several studies from the field of psychology emphasizing that human attention is limited, and that attention must be selective due to these constraints (see e.g., Neely, 1977; Pashler et al., 2001). Thus, in order to successfully complete a task, individuals must actively shift their attention towards this task and neglect other potentially important tasks. In contrast, attempting to focus on many tasks at the same time usually results in a performance decline.

Building on these findings from the psychology literature, finance and accounting scholars have argued that investor attention is also limited (see e.g., DellaVigna and Pollet, 2009; Hirshleifer and Teoh, 2003; Hirshleifer et al., 2009, 2011; Peng and Xiong, 2006).[4] According to their studies, even institutional investors, who typically devote much more time and resources than retail investors (Grinstein and Michaely, 2005), can unlikely process all the information arriving on capital markets at the same time. In this

[4]Other research focuses on limited regulator attention as well (see e.g., Ege et al., 2020; Gunny and Hermis, 2020; Köchling et al., 2021).

respect, Hirshleifer et al. (2009), Ben-Rephael et al. (2017), as well as Israeli et al. (2022), for example, find that (institutional) investors underreact to corporate announcements when there are more *distracting* news.

Similarly, previous studies have also argued that due to these attention constraints, institutional investors, who usually act as important external monitors (see e.g., Chung et al., 2002; Cornett et al., 2007; Kang et al., 2018), are unable to simultaneously monitor all the firms in their portfolios with the same intensity (see e.g., Garel et al., 2021; Kempf et al., 2017; Ni et al., 2020). Specifically, the authors argue that institutional investors have to shift their limited attention towards those firms which they believe require their attention. Since the psychology literature shows that individuals focus their attention on the most salient tasks (see e.g., Taylor and Fiske, 1978), the authors assume that institutional investors shift their attention towards those firms in industries that perform either extremely well or poorly. However, according to the authors, if institutional investors do indeed shift their attention towards firms in these industries, this likely loosens monitoring constraints at other firms in their portfolios and enables the firms' managers to maximize their private benefits.

Kempf et al. (2017) refer to this as the *Distracted Shareholder Hypothesis*. This hypothesis is based on two assumptions: (I) managers know when the firm's largest shareholders are distracted, and (II) other monitors cannot immediately compensate for the lack of institutional monitoring. Yet, both assumptions are likely fulfilled since managers typically know their largest shareholders as well as their portfolios[5], and other monitors, especially the board, cannot compensate for the lack of monitoring without costs. Regarding the latter, Liu et al. (2020) even highlight that board monitoring is also weaker

[5]There is a large body of literature showing that firms interact with their largest shareholders through their IR departments (see e.g., Bushee and Miller, 2012; Neukirchen et al., 2023; Rao and Sivakumar, 1999).

during periods of institutional distraction, which might make it even easier for managers to maximize their private benefits.

The findings in Kempf et al. (2017) confirm their hypothesis since they find managers to exploit periods where their largest shareholders are distracted. During these periods, managers are more likely to engage in value-destroying acquisitions, to receive more "lucky" equity grants, to cut dividends, and they are also less likely to be fired for bad performance (Kempf et al., 2017). Additionally, prior studies have shown that managers exploit these periods to engage in earnings management and tax planning, and they also change their general disclosure choices (see e.g., Abramova et al., 2020; Garel et al., 2021; Li et al., 2021; Ni et al., 2020).

However, while these studies provide strong evidence that managers exploit periods of institutional distraction to engage in actions primarily to the detriment of shareholders, there is still, to the best of our knowledge, no direct evidence that managers also commit significantly more wrongdoing that is to the detriment of various stakeholders during these periods. In this paper, we therefore examine the following main hypothesis:

Hypothesis I: Managers are more likely to engage in stakeholder-related misconduct during periods of institutional distraction.

The rationale behind our hypothesis is that (stakeholder-related) misconduct can ultimately be seen as a "risky" project that managers may consider in order to boost firm profitability and, more importantly, their own wealth, as their compensation package typically includes stock options (Chircop et al., 2022). In this respect, consider the example of workplace misconduct proposed in Chircop et al. (2022).[6] While actions regarded

[6]Caskey and Ozel (2017) find firms that meet or just beat analyst forecasts to be associated with more employee injury rates compared to those that miss or comfortably beat analyst forecasts. Further, Raghunandan (2021) documents that managers engage in wage theft when they are under performance pressures.

as workplace misconduct (e.g., forcing employees to work long hours, disregarding the safety and health regulation, etc.) can improve productivity and company performance and ultimately the CEO's wealth, they can also lead to a significant drop in share price if detected.[7] Given that institutional investors usually hold a significant proportion of the firm's shares and may have also committed to a socially responsible investment strategy (see e.g., Dimson et al., 2015; Dyck et al., 2019), they would probably question whether managers should undertake such projects. So to avoid these conflicts, managers may therefore specifically exploit periods of institutional distraction to commit (stakeholder-related) misconduct.

However, it seems likely that managers, before exploiting periods of institutional distraction for stakeholder-related misconduct, weigh whether their potential benefits are greater than their drawbacks. Especially, CEOs with fewer outside options in the executive labor market can be expected to be more reluctant to engage in stakeholder-related misconduct during periods of institutional distraction, as it would be more difficult for them to find a new job if they lose their job when misconduct is exposed. Similarly, managers holding a large proportion of the firm's shares or those with weaker equity compensation incentives might be less willing to take the risk and engage in stakeholder-related misconduct during periods of institutional distraction. Accordingly, we hypothesize:

Hypothesis II: Managers with more (less) outside options in the executive labor market or those with stronger (weaker) equity incentives are more likely to engage in stakeholder-related misconduct during periods of institutional distraction.

Apart from their personal incentives, it also seems reasonable to assume that whether

[7]Similar arguments can also be made for other forms of stakeholder-related misconduct such as environment-related and consumer-protection-related misconduct.

managers engage in stakeholder-related misconduct during periods of institutional distraction is dependent on whether other external and internal monitors can compensate for the lack of institutional monitoring (see e.g., Heese, 2018; Heese and Pérez-Cavazos, 2020; Heese et al., 2021; Neukirchen et al., 2022; Zaman et al., 2021). Especially, when other monitors cannot compensate, it seems likely that managers might be more likely to engage in misconduct. In this respect, Heese et al. (2021), for example, document that there is more corporate misconduct after closures of the local press, while Zaman et al. (2021) find managers to commit more wrongdoing when a higher proportion of the board members are coopted.[8]. We therefore formulate our third and last hypothesis as follows:

Hypothesis III: Managers are more likely to engage in stakeholder-related misconduct during periods of institutional distraction when other external and internal monitors cannot compensate for the lack of institutional monitoring.

3 Data and Variables

In this section, we explain how we construct our sample and define the variables to investigate our hypotheses. Besides, we provide summary statistics and correlations.

3.1 Sample Construction

We merge data from several sources to construct our sample. First, we obtain data on corporate misconduct from the Violation Tracker database and merge this data set with accounting data from Compustat and stock data from the Center for Research in Security

[8]Relatedly, Huang et al. (2019) show that co-opted boards have a lower probability of adopting clawback policies, a type of corporate governance mechanism designed to ex ante deter executives from misconduct, and to ex post penalize executives who do so.

Prices (CRSP) using ticker symbols and manual interventions.[9] We then complement our data set with the data on institutional distraction used in Kempf et al. (2017), which we obtain from Alberto Manconi's personal website. However, as the data from Alberto Manconi's website is restricted to the period from 2000 to 2011, we finally use data on institutional holdings from Michael Sinkinson's website[10] to extend the data set to 2017. This leaves us with a baseline sample of 9,887 firm-year observations of US public firms covering the period from 2000 through 2017.

3.2 Variables

3.2.1 Measures of Corporate Misconduct

Previous research on corporate misconduct has largely focused on management actions that are primarily to the detriment of shareholders. For instance, prior studies have examined financial misreporting (see e.g., Armstrong et al., 2013; Beasley et al., 2000; Wahid, 2019), accounting irregularities (Armstrong et al., 2010), and financial market manipulations (see e.g., Cumming et al., 2015). However, corporate misconduct that is to the detriment of various stakeholders has been studied only recently (see e.g., Heese and Pérez-Cavazos, 2020; Heese et al., 2021; Neukirchen et al., 2022; Raghunandan, 2021; Zaman et al., 2021, 2022).

We build on this latter strand of literature and employ, as noted earlier, data on corporate misconduct from the Violation Tracker database to investigate our hypotheses. This database, which is produced by the Corporate Research Project of Good Jobs First, contains detailed records of corporate violations, which resulted in penalties exceeding

[9] We check for each match manually whether the company name in the Violation Tracker database is similar to the one reported in Compustat.

[10] This data set has been used in Backus et al. (2021) and is based on parsed 13f filings directly obtained from the EDGAR database. The reason why we do not use the Thomson Reuters (TR) "S34" data set is that Backus et al. (2021) note that there are a number of issues with this data set.

US$ 5,000 and were related to eight broad offense groups, i.e., I) competition-related offenses, II) consumer-protection-related offenses, III) employment-related offenses, IV) environment-related offenses, V) financial offenses, VI) government-contracting-related offenses, VII) healthcare-related offenses, and VIII) safety-related offenses. Figure 1 shows how important the different offense groups are in our sample.[11] As can be seen, more than 95% of the violations in our sample are categorized as consumer-protection-related offenses, employment-related offense, environment-related offenses, and safety-related offenses. The latter offense group is the most prevalent in our sample and accounts for roughly 50% of the violations.

Following prior studies, we employ two measures of corporate misconduct based on the data from the Violation Tracker database in our empirical analysis. The primary measure we use is the natural logarithm of one plus the number of violations related to all offense groups of a company in a given year (*ln(Number of Penalties)*), while our secondary measure, which we use in robustness checks, is the natural logarithm of one plus the sum of penalties imposed on a firm due to violations related to all offense groups in a given year (*ln(Total Penalties)*).

3.2.2 Measures of Institutional Distraction

As mentioned above, we obtain the data on institutional distraction used in Kempf et al. (2017) from Alberto Manconi's website, but extend it to 2017 using data on institutional holdings from Michael Sinkinson's website. To do so, we closely follow the methodology described in detail in Kempf et al. (2017). For reasons of brevity, we only provide a brief description in this section and refer the reader to the original paper for further details.

So in short, the firm-level measure of institutional investor distraction, which Kempf

[11] It is important to note that we do not find any competition-related or healthcare-related offenses in our sample.

et al. (2017) propose and is denoted by D, can be described as:

$$D_{f,q} = \sum_{i \in F_{q-1}} \sum_{IND \neq IND_f} w_{i,f,q-1} \times w_{i,q-1}^{IND} \times IS_q^{IND} \tag{1}$$

where f denotes the firm and q denotes the quarter. F_{q-1} is the set of institutional investors holding shares of firm f at the end of quarter $q-1$, IND is a given industry within the Fama-French 12 industry classification, and IND_f is firm f's industry. IS_q^{IND} is a proxy for a distracting event (i.e., an *industry shock* leading to either *extreme* positive or negative returns) that occurs in an industry that is unrelated to firm f's industry. $w_{i,q-1}^{IND}$ is a weight that captures how important this industry is to investor i's portfolio, while the weight $w_{i,f,q-1}$ captures the importance of investor i to firm f. In sum, the measure of Kempf et al. (2017) therefore depends on whether shocks occur in other industries, whether these industries are important to investors, and whether investors that are highly affected by the unrelated shock are important monitors of the firm.

However, as can be seen from equation (1), the original distraction measure proposed by Kempf et al. (2017) is calculated on quarter-level. To employ this measure in our setting with annual data, we therefore calculate the average institutional investor distraction across all quarters in a fiscal year. Kempf et al. (2017) have also done this in settings with annual data. We call this measure *Distraction*, which is our primary measure in our empirical analysis. Additionally, we also construct a dummy variable called *Distraction Dummy*, which equals one if the firm's *Distraction* score is above the sample median, and zero otherwise.

3.2.3 Control Variables

We follow prior studies (see e.g., Zaman et al., 2021, 2022) and control for several basic firm characteristics in our baseline tests. These include the firm's size defined as the natural logarithm of total assets (*ln(Firm Size)*), the firm's age defined as the natural logarithm of the age (*ln(Firm Age)*), the firm's stock performance defined as the annual buy and hold stock return (*Stock Return*), the firm's stock volatility defined as the annualized standard deviation of daily stock returns (*Stock Volatility*), the firm's return on assets defined as the operating income before depreciation divided by assets (*ROA*), the firm's leverage defined as the total liabilities divided by assets (*Leverage*), the firm's ratio of capital expenditures defined as the capital expenditures divided by assets (*Capex*), the firm's cash holdings defined as the cash holdings divided by assets (*Cash Holdings*), the firm's market-to-book ratio defined as the market value of equity divided by its book equity (*Market to Book*), and the firm's fraction of shares held by institutional investors (*Inst. Ownership*).

In additional tests, we also include further control variables. Yet, for reasons of brevity, we explain the construction of these variables in detail in Table A1 in the Appendix.

3.3 Descriptive Statistics and Correlations

Table 1 reports summary statistics for the variables in our baseline sample.[12] As can be seen, firms in our sample have on average been involved in 2.7 incidents of corporate wrongdoing in a year, and the fines for these cases amounted to US$ 7.9 million. In terms of firm characteristics, the summary statistics show that the average firm in our sample holds US$ 22.27 billion in assets, is 32 years old, and has an average *Market to Book* of

[12]We note that all continuous variables are winsorized at the 1st and 99th percentiles to account for outliers throughout the analysis.

2.95. Finally, it can be seen that the average institutional distraction (*Distraction*) in our sample amounts to 16% and exhibits significant variation.

Table 2 displays pairwise correlations between the variables in our sample. It is worthwhile to mention that the correlations between our measures of institutional distraction (*Distraction* and *Distraction Dummy*) and our measures of corporate misconduct (*ln(Number of Penalties)*) and *ln(Total Penalties)*) are positive and significant, which is in line with our main hypothesis. Besides, we note that the correlations between our control variables are moderate. Thus, multicollinearity should not affect our results.

Insert Tables 1 and 2 about here.

4 Results

In the following, we examine whether managers commit significantly more wrongdoing when institutional investors are distracted. In Section 4.1, we therefore present our main regression specification and the corresponding results. In Section 4.2, we report the results from several robustness checks. In Section 4.3, we provide the results from tests for cross-sectional heterogeneity allowing us to better understand the mechanisms behind the relationship. Finally, in Section 4.4, we discuss the results from additional tests.

4.1 Baseline Results

To examine the relationship between institutional distraction and corporate misconduct, we perform the baseline ordinary least squares (OLS) regression shown in Equation (2),

where i is the firm and t is the year:

$$ln(Number\ of\ Penalties_{i,t+1}) = \beta_0 + \beta_1 \times Distraction_{i,t} + \beta' \times X_{i,t} + Industry\ FE + Year\ FE\ +\ \varepsilon_{i,t} \quad (2)$$

The dependent variable is *ln(Number of Penalties)*, and the main independent variable of interest is *Distraction*. We also include a vector of control variables denoted by X as well as Fama-French 48-industry dummies denoted by *Industry FE* and year dummies denoted by *Year FE*. It is, however, important to note that the dependent variable enters the regression with a one-year lead compared to our main independent variable and also to our control variables. The rationale behind this is that we assume that corporate violations likely happen in year t in which we measure institutional distraction, but are likely to be detected in the next year (if at all). This is, of course, an empirical choice. Yet, given that our measure of institutional distraction is by construction exogenous, we believe that this should, if at all, work against us finding results consistent with our hypotheses, and that the effect is rather underestimated.[13]

Panel A of Table 3 shows the results from our baseline OLS regressions. We note that the t-statistics reported in parentheses are based on standard errors clustered by firm.[14] In column (1), we report the results from a regression where we omit the firm-level control variables and only control for industry and year fixed effects. Consistent with our hypothesis, the coefficient on *Distraction* is positive and significant. In column (2), we repeat this regression, but include the additional firm-level control variables. The

[13]Heese et al. (2021) make a similar argument in their paper. Specifically, they claim: "When interpreting these magnitudes, it is important to note that our empirical tests rely on detected violations, as undetected violations are unobservable. As a result, these magnitudes are likely a lower-bound estimate."

[14]We also cluster by industry or by industry and year, and find qualitatively similar results. The results are reported in Table S2 in our online appendix.

results show that the coefficient on *Distraction* remains positive and significant and is also similar in size. The estimate suggests that a one standard deviation increase in *Distraction* is associated with a 5.1% increase in the number of violations. Regarding the control variables, the results further show that larger and older firms, those with better operating performance, and those with higher stock volatility appear to be associated with more violations, while those with more cash holdings appear to be associated with less violations.

However, while the results presented in Panel A are consistent with our hypothesis, there is literature stressing that running OLS regressions with log-transformed count data as the dependent variable, which includes a large proportion of zeros, may bias the results (see e.g., Call et al., 2018; Karolyi and Taboada, 2015; Silva and Tenreyro, 2006). To address this concern, we also estimate our main specification using the Poisson pseudo-maximum likelihood (PPML) estimator and the untransformed number of violations as the dependent variable. The results are reported in Panel B. As can be seen, we still find positive and highly significant coefficients on our main variable of interest *Distraction*. We therefore conclude that the results from our baseline tests lend support to our main hypothesis since managers appear to be more likely to commit wrongdoing when they face weaker monitoring by institutional investors.

Insert Table 3 about here.

4.2 Further Robustness Tests

To ensure that our main finding is robust, we estimate several different regression specifications. For reasons of brevity, we show only some of the results in Table 4, while the

others are reported in our online appendix.

Insert Table 4 about here.

For our first robustness test, we follow Garel et al. (2021) and reestimate the regressions from Panel A of Table 3 using a first-difference regression model to account for any unobserved time-invariant heterogeneity. Panel A reports the results. Across both columns, we find that the coefficient on *Distraction* remains positive and significant. This suggests that a within-firm change in institutional distraction is associated with changes in the number of violations. We also test whether the results in column (2) hold using a firm fixed effects model (or when we include industry-by-year fixed effects) and find that they do.[15] Therefore, we can rule out that unobserved time-invariant heterogeneity is affecting our results. In our online appendix, we further alleviate concerns related to omitted variable bias by including several additional control variables and find that this does not affect our results.

The second robustness test we perform is to reestimate our baseline OLS regressions, but using our secondary measure of corporate misconduct ($ln(Total\ Penalties_{t+1})$) as the dependent variable. Panel B reports the results. As can be seen, the coefficients on *Distraction* remain positive and significant, and the effect is also economically meaningful. For instance, the estimate in column (2) suggests that a one standard deviation increase in *Distraction* is associated with a 30.7% increase in total penalties.

For our third robustness test, we reestimate our baseline specification as well as the specification from column (2) of Panel A of Table 4, but include the lagged dependent variable as an additional control variable. This helps us to capture any dynamic effects

[15]These results are reported in Table S1 in the online appendix.

and to address autocorrelation concerns. However, the results, which are reported in Panel C, are very similar to those found earlier. Regardless of whether we use *ln(Number of Penalties$_{t+1}$)* in column (1) or *ln(Total Penalties$_{t+1}$)* in column (2) as the dependent variable, we still find positive and significant coefficients on *Distraction*, which are also similar in size compared to our previous results.

As a fourth robustness check, we follow Kempf et al. (2017) and exploit time variation in our main independent variable. We thus include the one-year lagged *Distraction* measure (as well as the lagged dependent variable) as an additional control variable. The results displayed in Panel D show that one-year lagged *Distraction* does not have a significant effect on corporate misconduct measured in year $t + 1$, while the effect of *Distraction* measured in year t remains positive and significant. In unreported results, we also include additional lags of *Distraction* as well as *Distraction* measured in year $t + 1$ and find very similar results. This is consistent with our hypothesis stating that managers specifically exploit periods where institutional investors are distracted to engage in corporate misconduct.

For our fifth robustness check, we employ our alternative independent variable *Distraction Dummy*, which equals one if the firm's *Distraction* score is above the sample median, and zero otherwise. The results from the regressions using this alternative independent variable are shown in Panel E. In both columns, we find a positive and significant coefficient on *Distraction Dummy*. In terms of economic significance, the results suggest that firms with a high proportion of distracted institutional shareholders are associated with approximately 9% more violations and 55% higher penalties. We note that these results also hold using a firm fixed effects model, as shown in our online appendix.

The sixth robustness check we perform is to estimate a linear probability model (LPM)

as well as a logit model using the dummy variable $Misconduct_{t+1}$ as the dependent variable. This variable equals one if the firm was penalized in year $t+1$ for engaging in corporate misconduct, i.e., if the number of penalties is larger than zero. The results reported in Panel F show that the coefficients on *Distraction* are positive and significant, which is consistent with our hypothesis and our previous results.

Finally, for our seventh robustness check, we define our two primary measures of corporate misconduct differently. The rationale behind is that although our two main dependent variables enter the regressions with a one-year lead, it might be the case that the detection and sanctioning of misconduct needs a longer time period than just one year. To tackle this issue, we employ the cumulative number of violations as well the cumulative amount of penalties over the period from year $t+1$ to $t+2$ as alternative dependent variables.[16] Panel G displays the results from these regressions. As can be seen, consistent with our previous results, the coefficients on *Distraction* are positive and significant in both columns.

Taken together, the results from our robustness tests lend strong support to our previous results and our main hypothesis. Managers appear to strategically exploit periods where institutional investors are distracted to commit wrongdoing. Hence, we conclude that institutional monitoring matters for preventing misconduct that is to the detriment of both shareholders and stakeholders.

4.3 Cross-Sectional Heterogeneity

After having shown that our main finding is robust, we next turn to tests for cross-sectional heterogeneity that allow us to identify the potential mechanisms explaining the link between institutional distraction and managers' propensity to commit (stakeholder-

[16] In unreported tests, we also use the period from year $t+1$ to $t+3$ and find qualitatively similar results.

related) misconduct.

4.3.1 CEO Incentives, Institutional Investor Distraction, and Corporate Misconduct

In this respect, we first examine whether the effect of institutional distraction is more pronounced when CEOs possess more outside options in the executive labor market or when they are more enticed to commit wrongdoing because of their equity incentives (Hypothesis II). The rationale behind this is that CEOs might be more willing to exploit periods of institutional distraction when their potential benefits might outweigh their disadvantages. To investigate this, we split the sample based on seven proxies: (I) the *GAI* (Custódio et al., 2013), (II) the *MA Score* (Demerjian et al., 2012), (III) the CEO's tenure with firm, (IV) the CEO's age, (V) the CEO founder status, (VI) the proportion of the firm's shares held by the CEO, and (VII) the ratio of CEO vega to CEO delta.[17]

Regarding our first proxy, we expect that the association between institutional distraction and corporate misconduct is more pronounced when CEOs have a higher *GAI*. This is because Custódio et al. (2019) show that generalist CEOs, i.e., CEOs with a higher GAI, possess more outside options in the executive labor market. Given that executives might lose their jobs if misconduct is detected, CEOs who have more (less) outside options might be more (less) willing to take the risk and exploit periods of institutional distraction.

A similar argument can be made for our second proxy since high-ability CEOs (as measured by the *MA score*) likely have more outside options. Apart from that, recent research also shows that high-ability managers are associated with more intentional earn-

[17] We obtain the data on CEO characteristics and stock holdings from Execucomp, the data on CEO vega and delta from Lalitha Naveen's personal website, the data on GAI from Claudia Custodio, and the data on managerial ability from Peter Demerjian's website.

ings smoothing when they expect it to benefit themselves (Demerjian et al., 2020). We thus argue that high-ability managers, who think that projects involving wrongdoing benefit themselves, may be more likely to undertake them.

Regarding our third, fourth, and fifth proxy, it seems natural to assume that older and more tenured CEOs as well as founder CEOs have fewer outside options (see e.g., Fee et al., 2018) and are therefore more reluctant to engage in misconduct during periods of institutional distraction.

As for our last two proxies, we turn away from the potential outside options and focus on the equity incentives that CEOs may have that tempt them to commit misconduct during periods of institutional distraction. So regarding the proportion of the firm's shares held by the CEO, we expect the effect to be stronger when CEOs hold only a small proportion of the firm's shares. This is because negative repercussions from engaging in wrongdoing may only have a small impact on the CEO's personal wealth. Finally, regarding the ratio of CEO vega to CEO delta, we expect CEOs with higher ratios to be more likely to commit wrongdoing during periods of institutional distraction. As mentioned earlier, the reason is that CEOs will likely weigh up whether engaging in misconduct will increase or decrease their own wealth. Our measure, which we borrow from Nguyen et al. (2016), captures this since CEO vega measures the change in CEO wealth relative to an increase in stock return volatility, while CEO delta measures the change in CEO wealth relative to an increase of the stock price (Coles et al., 2006). As wrongdoing likely increases equity risk and may lead to a decline in the firm's stock price (Wang et al., 2022), it seems reasonable to assume that CEOs with higher ratios of vega to delta are more likely to consider engaging in misconduct during periods of institutional distraction.

Table 5 displays the results from these subsample regressions, where the dependent variable is our primary measure of corporate misconduct called *ln(Number of Penalties$_{t+1}$)*. As can be seen, we find positive and significant coefficients on *Distraction* for all subsamples of firms where CEOs either possess more outside options or where they are more tempted to commit misconduct due to their equity incentives (columns (1), (3), (6), (8), (10), (12), & (13)). In contrast, we do not find significant coefficients on *Distraction* in the remaining subsamples (except for column (14)). Further, the results show that the tests for the equality of the coefficients support our findings for four of our seven proxies: *GAI*, *MA Score*, *CEO Tenure*, and *CEO Age*. For the remaining proxies, the p-values from these tests are slightly above conventional levels indicating statistical significance. However, we note that for two of those proxies (*CEO Founder* and *Vega Delta Ratio*), we find significant effects consistent with our hypothesis when we use regressions including interaction terms. These results are reported in Table S7 in our online appendix.

In untabulated regressions, which are available upon request, we also find qualitatively similar results using our alternative independent variable (*Distraction Dummy*), our alternative dependent variables, and first-differences specifications. We therefore believe that our results are strongly consistent with our expectation and strengthen our proposed mechanism that managers strategically exploit periods where institutional investors are distracted to commit misconduct when their potential benefits outweigh their disadvantages.

Insert Table 5 about here.

4.3.2 Internal Governance, Institutional Investor Distraction, and Corporate Misconduct

We next examine whether the firms' internal governance structures affect the relation between institutional investor distraction and managers' propensity to engage in wrongdoing (Hypothesis 3). To do this, we split the sample based on three proxies for the firms' internal governance quality: (I) the well-known GIM index (Gompers et al., 2003), (II) the board size, and (III) the proportion of independent directors.[18] We expect the relation to be more pronounced for firms with weak governance (i.e., those with high scores on the GIM index, those with larger boards[19], and those with a smaller proportion of independent directors on the board) since these firms can unlikely compensate for the loss of institutional monitoring during these periods.

Insert Table 6 about here.

Table 6 reports the results. Using all three proxies for internal governance quality, we find positive and significant coefficients on *Distraction* for the subsamples of firms with weaker internal governance (columns (1), (3), & (6)). In contrast, we do not find a significant effect of institutional distraction on corporate misconduct for the subsamples of firms with stronger internal governance (columns (2), (4), & (5)). The $p-$values for the tests for the equality of coefficients also indicate that the differences are statistically significant for the subsamples based on the *GIM* index and board size. The p-value of 13.7% for the subsamples based on board independence is slightly above conventional levels of statistical

[18] We obtain the data on the GIM index from Andrew Metrick's personal website. The data on board characteristics are from BoardEx.

[19] Although this has been questioned recently by Wintoki et al. (2012), there is a large body of literature suggesting that larger boards tend to monitor management less effectively and that companies with larger boards are therefore associated with lower market valuations (see e.g., Adams et al., 2018; Bhagat and Black, 2001; Yermack, 1996).

significance. Nonetheless, the results suggest that strong internal governance structures might be sufficient to compensate for the lack of institutional monitoring as they prevent managers from engaging in corporate misconduct.

As before, we also use our alternative independent variable *Distraction Dummy*, our alternative dependent variable $ln(Total\ Penalties_{t+1})$, and first-difference specifications in untabulated regressions and find that the results are qualitatively similar. These results are available upon request.

4.3.3 External Monitoring, Institutional Investor Distraction, and Corporate Misconduct

For our final set of tests for cross-sectional heterogeneity, we focus on the impact of external monitoring. While we have shown that the effect of institutional distraction on managers' propensity to engage in misconduct is even more pronounced when internal governance is weak, it seems natural to assume that a similar effect can be observed when external governance is weak. We proxy for external monitoring by using (I) the number of analysts following the firm and (II) the sum of the unique daily clicks on corporate disclosures according to the SEC EDGAR server log files. The rationale behind using the first proxy is that there is a large body of literature highlighting that analyst coverage improves information transparency, and that analysts thus act as effective external monitors (see e.g., Chen et al., 2015). In our setting, we therefore expect the effect of institutional distraction on corporate misconduct to be stronger when there is weak external monitoring by analysts. Regarding our second proxy, there is also previous research showing that EDGAR clicks are a good measure of how strong institutional investors monitor the firm (see e.g., Iliev et al., 2021; Li et al., 2019). Compared to using the proportion of the firm's shares held by institutional investors, this proxy has also the advantage of covering

those institutional investors, who follow the firm but are not necessarily invested in it. Consistent with the notion in previous research, we expect that external monitoring is weaker when EDGAR clicks are lower.

In Table 7, we report the results from regressions using subsamples based on these two proxies.[20] Consistent with our conjectures, the coefficients on *Distraction* are positive and significant for the subsamples of firms with weak external monitoring (columns (2) & (4)). In contrast, we do not find significant effects for the subsamples of firms with strong external governance. However, we note that the test for the equality of coefficients only supports our results for the sample split based on the number of analysts following the firm. Nonetheless, we believe that overall these results suggest that when other external monitors cannot substitute for institutional monitoring, managers engage in significantly more misconduct.

Insert Table 7 about here.

4.4 Institutional Investor Distraction and Dimensions of Corporate Misconduct

In the previous sections, we have shown that there is significant variation in our results when we split the sample based on the CEOs' outside options and equity incentives, and the firms' internal and external governance structures. In this section, we exploit the advantage of the Violation Tracker database in that it covers different offense groups. We can therefore specifically examine the association between institutional distraction and different groups of corporate misconduct. However, as mentioned earlier, managers often engage in a variety of unusual practices in order to boost firm profitability and, more

[20] Again, we note that we find similar qualitatively similar results in untabulated regressions using our alternative independent variable *Distraction Dummy*, our alternative dependent variable $ln(Total\ Penalties_{t+1})$, or first-difference specifications. These results are available upon request.

importantly, their own wealth (Chircop et al., 2022; Heese and Pérez-Cavazos, 2020). We therefore assume that managers not only engage in misconduct related to a particular offense group but rather to several offense groups.

To investigate this, we perform OLS regressions where we employ the natural logarithm of one plus the number of violations due to offenses categorized as I) consumer-protection-related offenses, II) employment-related offenses, III) environment-related offenses, and IV) safety-related offenses as the dependent variable. We focus on these four offense groups because they are the most prevalent in our sample and account for more than 95% of the violations (see Figure 1). The results from the regressions are displayed in Table 8. Consistent with our main hypothesis, we find that the coefficients on *Distraction* are positive and significant for all four offense groups, and that they are also economically meaningful. For instance, the coefficient in column (2) suggests that a one standard deviation increase in institutional distraction corresponds to a roughly 2% increase in employment-related violations.

Insert Table 8 about here.

In Table S8 in our online appendix, we also show the results from regressions where we test for cross-sectional heterogeneity using the dependent variables based on these four offense groups and the proxies from Section 4.3.1. The results largely support our earlier results. An interesting result worth mentioning is, however, that managers with high ratios of vega to delta appear to engage in significantly more employment-related misconduct during periods of institutional distraction. This finding is not only consistent with Hypothesis II but also with Chircop et al. (2022) and Raghunandan (2021).

5 Discussion and Conclusion

In this paper, we follow Kempf et al. (2017) and exploit exogenous shocks to institutional investor portfolios to show that managers engage in significantly more stakeholder-related misconduct when institutional investors are distracted. Using data from the Violation Tracker database and a sample of 9,887 firm-year observations spanning the period from 2000 to 2017, we find a meaningful economic effect in our baseline tests, i.e., a one standard deviation increase in our measure of institutional distraction is associated with a 5.1% increase in the number of violations and a 30.7% increase in the resulting penalties. The effect is even stronger when CEOs have more outside options or stronger equity incentives, which speaks to the potential mechanism that CEOs weigh up the benefits and disadvantages before exploiting periods of institutional distraction to commit wrongdoing. Consistent with prior literature, our results also show that weak internal and external governance structures make it easier for managers to exploit these periods. Finally, we show that these results are not driven by violations related to a single offense group since managers appear to exploit periods of institutional distraction to engage in a variety of different violations.

Our findings contribute to the literature by providing systematic evidence, (mostly) free of endogeneity concerns, that institutional investors are important monitors and appear to prevent not only shareholder-related misconduct but also stakeholder-related misconduct when they are not distracted. This finding extends the literature examining the relation between institutional investors and corporate social responsibility. Further, our study more broadly expands the literature examining managers' incentives to engange in corporate wrongdoing.

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Appendix

Table A1: Variable Definitions

Variable	Definition
Dependent Variables	
ln(Number of Penalties)	The natural logarithm of one plus the number of violations of a company related to all offense groups
ln(Total Penalties)	The natural logarithm of one plus the sum of penalties imposed on a company due violations related to all offense groups
Main Independent Variables	
Distraction	Company-level proxy for the proportion of the company's institutional investors that are distracted during the fiscal year. The data are obtained from Kempf et al. (2017). A detailed description is also provided in Section 3.2
Distraction Dummy	Dummy variable, which equals one if a company's *Distraction* value is above the sample median, and zero otherwise
Baseline Control Variables	
Capex	The company's capital expenditures divided by its total assets
Cash	The company's cash holding divided by its total assets
Inst. Ownership	The fraction of the company's shares held by institutional investors
Leverage	The company's total liabilities divided by its total assets
ln(Age)	The natural logarithm of the company's age
ln(Size)	The natural logarithm of the company's total assets
Market to Book	The company's market value of equity divided by its book equity
ROA	The company's return on assets calculated as its operating income before depreciation divided by its total assets
Volatility	The annualized standard deviation of the company's daily stock returns
Return	The company's annual buy and hold stock return
Additional Variables	
Abnormal Earnings	The difference between the income before extraordinary items adjusted for common stock equivalents in year t and $t-1$, divided by the company's market value of equity
Analysts	Number of analysts following the company
Board Age	The mean of the directors' age
Board Independence	The proportion of independent directors on the board
Board Size	Number of directors on the board
Board Tenure	The mean of the directors' tenure on the board
CEO Age	The CEO's age
CEO Duality	Dummy variable equaling one if the CEO is also the chairman of the board, and zero otherwise
CEO Delta	CEO delta measures the change in CEO wealth relative to an increase of the stock price
CEO Founder	Dummy variable equaling one if the CEO is the company's founder, and zero otherwise
CEO Gender	Dummy variable equaling one if the CEO is male, and zero otherwise
CEO Ownership	The proportion of the company's shares held by the CEO
CEO Tenure	The CEO's tenure with the company in her current position
CEO Vega	CEO vega measures the change in CEO wealth relative to an increase in stock return volatility
# Disclosure Views	The aggregated number of unique daily clicks on corporate disclosures according to the SEC EDGAR server log file
E Score	The company's enviromental score from Refinitiv
G Score	The company's governance score from Refinitiv
GIM Score	Corporate governance score based on Gompers et al. (2003)
Intangibles	The company's intangible assets divided by its total assets
ln(Segments)	The natural logarithm of the company's business segments
MA Score	Managerial ability score based on (Demerjian et al., 2012)
Property	The company's property, plant, equipment divided by its total assets
R&D	The company's research and development expenditure divided by its total assets
Sales Growth	The growth in the company's sales from year $t-1$ to year t
S Score	The company's social score from Refinitiv
Vega Delta Ratio	The ratio of CEO vega to CEO delta

Note: This table describes the construction of the variables used in this study. We obtain accounting data from Compustat, stock data from CRSP, institutional ownership data from Michael Sinkinson's website, data on analysts from Thomson Reuters Eikon, board data from BoardEx, data on CEOs from Execucomp, data on CEO delta and vega from Lalitha Naveen' website, and data on corporate misconduct from the Violation Tracker database.

Figures and Tables

Figure 1: Categorization of Violations in the Sample

Note: This figure displays the proportion of violations in our sample that are categorized as safety-related offenses, employment-related offenses, environment-related offenses, consumer-protection-related offenses, government-related offenses, or financial-related offenses.

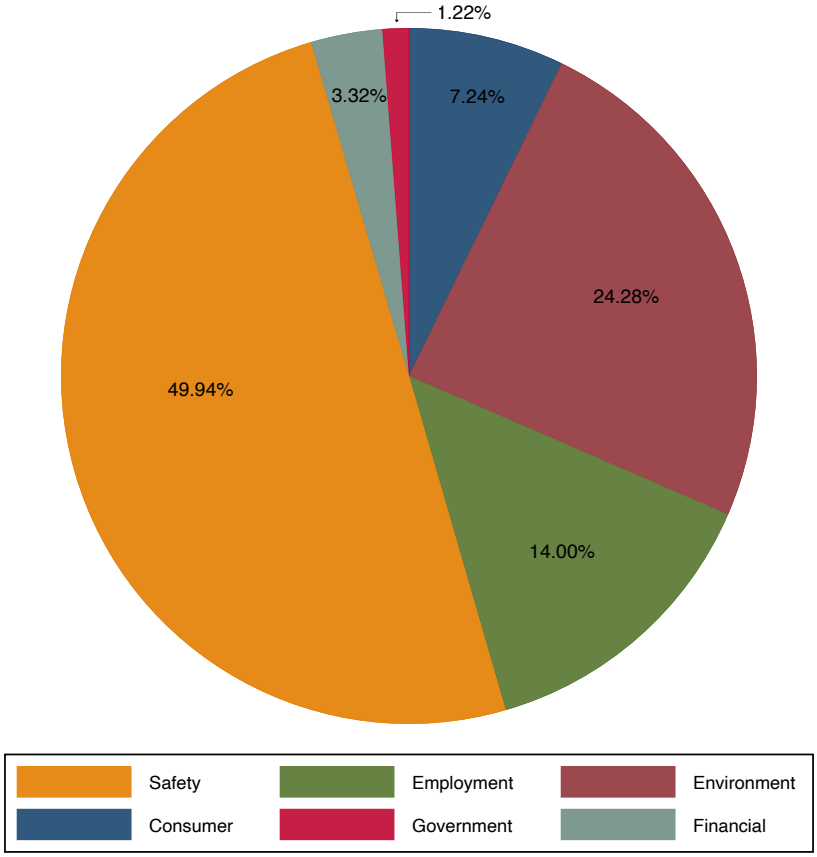

Table 1: Descriptive Statistics

	Obs.	Mean	25^{th}	50^{th}	75^{th}	Std.
Dependent Variables:						
Number of Penalties$_{t+1}$	9,887	2.7362	0.0000	1.0000	3.0000	5.1529
ln(Number of Penalties$_{t+1}$)	9,887	0.8756	0.0000	0.6931	1.3863	0.8380
Total Penalties$_{t+1}$ (in US$ million)	9,887	7.9463	0.0000	0.0200	0.2500	40.3945
ln(Total Penalties$_{t+1}$)	9,887	8.1260	0.0000	9.9035	12.4292	6.1653
Main Independent Variables:						
Distraction	9,887	0.1572	0.1283	0.1582	0.1778	0.0392
Distraction Dummy	9,887	0.5295	0.0000	1.0000	1.0000	0.4992
Control Variables:						
Size (in US$ billion)	9,887	22.2731	1.5660	4.6208	15.3100	67.3084
ln(Size)	9,887	8.5548	7.3569	8.4385	9.6363	1.6080
Age	9,887	32.3530	16.0000	29.0000	50.0000	18.8377
ln(Age)	9,887	3.2934	2.8332	3.4012	3.9318	0.7175
ROA	9,887	0.1356	0.0870	0.1282	0.1760	0.0758
Leverage	9,887	0.2593	0.1283	0.2458	0.3627	0.1756
Capex	9,887	0.0504	0.0189	0.0372	0.0652	0.0483
Cash	9,887	0.1008	0.0243	0.0635	0.1411	0.1086
Market to Book	9,887	2.9453	1.4309	2.1850	3.4706	4.1121
Volatility	9,887	0.3585	0.2354	0.3134	0.4313	0.1771
Return	9,887	0.1379	-0.0832	0.1130	0.3190	0.3790
Inst. Ownership	9,887	0.7469	0.6409	0.7795	0.8905	0.1896

Note: This table presents summary statistics for our final sample consisting of 9,887 firm-year observations of US public firms in the period from 2000 through 2017. All variables are defined in Table A1 in the Appendix. Besides, it is important to note that all continuous variables are winsorized at the 1^{st} and 99^{th} percentiles.

Table 2: Correlations

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)
(1) ln(Number of Penalties$_{t+1}$)	1.00													
(2) ln(Total Penalities$_{t+1}$)	0.81*	1.00												
(3) Distraction	0.06*	0.04*	1.00											
(4) Distraction Dummy	0.06*	0.04*	0.78*	1.00										
(5) ln(Size)	0.40*	0.39*	−0.02*	0.00	1.00									
(6) ln(Age)	0.18*	0.15*	0.07*	0.07*	0.30*	1.00								
(7) ROA	−0.05*	−0.06*	0.04*	0.03*	−0.24*	−0.03*	1.00							
(8) Leverage	0.08*	0.09*	0.09*	0.05*	0.12*	−0.03*	−0.08*	1.00						
(9) Capex	0.06*	0.02	0.08*	0.04*	−0.11*	−0.06*	0.27*	0.04*	1.00					
(10) Cash	−0.13*	−0.09*	−0.14*	−0.08*	−0.09*	−0.15*	0.13*	−0.28*	−0.14*	1.00				
(11) Market to Book	−0.01	0.00	0.02*	0.03*	0.01	0.01	0.28*	0.00	0.03*	0.09*	1.00			
(12) Volatility	−0.06*	−0.09*	0.03*	0.06*	−0.22*	−0.23*	−0.15*	0.07*	0.09*	0.07*	−0.12*	1.00		
(13) Return	−0.01	−0.01	0.01	0.03*	−0.06*	−0.05*	0.10*	−0.04*	−0.05*	0.08*	0.13*	−0.17*	1.00	
(14) Inst. Ownership	0.00	0.01	−0.08*	0.00	−0.09*	−0.12*	0.08*	−0.01	0.01	0.05*	0.03*	−0.02	0.03*	1.00

Note: This table reports pairwise correlations for the variables in our sample.* indicates significance at the 5% level or lower. All variables are defined in Table A1 in the Appendix.

Table 3: Institutional Investor Distraction and Corporate Misconduct

Panel A: OLS	ln(Number of Penalties$_{t+1}$)	
	(1)	(2)
Distraction	1.431***	1.312***
	(4.561)	(3.900)
ln(Size)		0.242***
		(15.837)
ln(Age)		0.060**
		(2.273)
ROA		0.510**
		(2.277)
Leverage		-0.072
		(-0.768)
Capex		-0.486
		(-1.137)
Cash		-0.404**
		(-2.451)
Market to Book		-0.004
		(-1.620)
Volatility		0.224**
		(2.074)
Return		0.021
		(1.046)
Inst. Ownership		0.058
		(0.602)
Industry FE	Yes	Yes
Year FE	Yes	Yes
N	10,516	9,887
Adjusted R^2	0.146	0.322

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Panel B: PPML	Number of Penalties$_{t+1}$	
	(1)	(2)
Distraction	2.500***	1.798***
	(4.028)	(2.950)
ln(Size)		0.463***
		(17.190)
ln(Age)		0.166**
		(2.469)
ROA		1.208**
		(2.402)
Leverage		-0.090
		(-0.397)
Capex		-1.469*
		(-1.779)
Cash		-0.911
		(-1.564)
Market to Book		-0.010**
		(-2.001)
Volatility		0.394
		(1.626)
Return		0.037
		(1.074)
Inst. Ownership		0.350*
		(1.678)
Industry FE	Yes	Yes
Year FE	Yes	Yes
N	10,516	9,887
Pseudo R^2	0.174	0.347

Note: Panel A of this table reports the results from OLS regressions where the dependent variable is *ln(Number of Penalties$_{t+1}$)* and the main independent variable of interest is *Distraction*. Panel B reports the results from similar PPML regressions using *Number of Penalties$_{t+1}$* as the dependent variable. All variables are defined in Table A1 in the Appendix. Below the coefficient estimates, we report t-statistics in parentheses based on standard errors clustered by firm. The following significance levels are indicated by asterisks: *** (1 %), ** (5 %), * (10 %).

Table 4: Robustness Tests

Panel A: First-Difference Estimation

	ln(Number of Penalties$_{t+1}$)	
	(1)	(2)
Distraction	0.492**	0.598**
	(1.994)	(2.267)
Controls	Yes	Yes
Industry FE	Yes	Yes
Year FE	Yes	Yes
N	9,305	8,555
Adjusted R^2	0.003	0.004

Panel B: Total Penalties as the Dependent Variable

	ln(Total Penalties$_{t+1}$)	
Distraction	9.188***	7.827***
	(3.328)	(2.769)
Controls	No	Yes
Industry FE	Yes	Yes
Year FE	Yes	Yes
N	10,516	9,887
Adjusted R^2	0.090	0.221

Panel C: Including Lagged Dependent Variable

	ln(Number of Penalties$_{t+1}$)	ln(Total Penalties$_{t+1}$)
Distraction	0.816***	6.707**
	(3.277)	(2.567)
ln(Number of Penalties)	0.544***	
	(28.481)	
ln(Total Penalties)		0.212***
		(15.425)
Controls	Yes	Yes
Industry FE	Yes	Yes
Year FE	Yes	Yes
N	9,887	9,887
Adjusted R^2	0.523	0.256

Panel D: Including Lagged Main Independent Variable

	ln(Number of Penalties$_{t+1}$)	ln(Total Penalties$_{t+1}$)
Distraction	0.825***	6.614**
	(3.173)	(2.452)
Distraction$_{t-1}$	0.053	1.853
	(0.209)	(0.715)
Dependent Variable$_t$	Yes	Yes
Controls	Yes	Yes
Industry FE	Yes	Yes
Year FE	Yes	Yes
N	8,987	8,987
Adjusted R^2	0.529	0.263

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Panel E: Alternative Specification of *Distraction*

	ln(Number of Penalties$_{t+1}$)	ln(Total Penalties$_{t+1}$)
Distraction Dummy	0.090***	0.545***
	(4.132)	(2.845)
Controls	Yes	Yes
Industry FE	Yes	Yes
Year FE	Yes	Yes
N	9,887	9,887
Adjusted R^2	0.322	0.220

Panel F: Linear Probability Model (left) and Logit (right)

	Misconduct$_{t+1}$	Misconduct$_{t+1}$
Distraction	0.630***	3.737***
	(2.879)	(3.225)
Controls	Yes	Yes
Industry FE	Yes	Yes
Year FE	Yes	Yes
N	9,887	9,887
(Pseudo) Adjusted R^2	0.159	0.123

Panel G: Alternative Specification of the Dependent Variables (aggregated for $t+1$ and $t+2$)

	ln(Number of Penalties)	ln(Total Penalties)
Distraction	1.511***	7.185**
	(3.541)	(2.534)
Controls	Yes	Yes
Industry FE	Yes	Yes
Year FE	Yes	Yes
N	8,933	8,933
Adjusted R^2	0.375	0.244

Note: This table reports the results from several robustness tests. In Panel A, we apply a first-difference estimator. Panel B shows the results for *ln(Total Penalties$_{t+1}$)* as the dependent variable, which is the sum of all penalties imposed on a company in $t+1$. In Panel C, we include the one-year lagged dependent variable as an additional control. In Panel D, we also include the one-year lagged main independent variable as an additional control. In Panel E, we use *Distraction Dummy* as the main independent variable of interest, which is a dummy variable indicating whether a firm's *Distraction* score is above the sample median. In Panel F, we estimate a linear probability model and a logit model using *Misconduct$_{t+1}$* as the dependent variable, which is a dummy variable that equals one if *ln(Number of Penalties$_{t+1}$)* is greater than zero. In Panel G, we employ the alternative dependent variables *ln(Number of Penalties$_{t+1\ to\ t+2}$)* and *ln(Total Penalties$_{t+1\ to\ t+2}$)*, which are the cumulative number of violations and the cumulative amount of penalties over the period from year $t+1$ to $t+2$. All regressions across all panels include industry fixed effects (based on the Fama-French 48 industry classification) and year fixed effects. All regressions also include the same set of firm controls as in our baseline regression reported in column (2) of Table 3. The coefficient estimates for these control variables are not reported for reasons of brevity. All variables are defined in Table A1 in the Appendix. Below the coefficient estimates, we report t-statistics in parentheses based on standard errors clustered by firm. The following significance levels are indicated by asterisks: *** (1 %), ** (5 %), * (10 %).

Table 5: CEO Incentives & Outside Options, Institutional Investor Distraction, and Corporate Misconduct

	ln(Number of Penalties$_{t+1}$)													
	GAI		MA Score		CEO Tenure		CEO Age		CEO Founder		CEO Ownership		Vega Delta Ratio	
	High	Low	High	Low	High	Low	High	Low	=1	=0	High	Low	High	Low
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)
Distraction	2.153***	0.769	2.050***	-0.146	-0.387	1.905***	-0.648	1.801***	0.143	1.526***	0.172	1.626***	1.951***	1.298***
	(3.851)	(1.578)	(3.906)	(-0.178)	(-0.525)	(4.637)	(-0.698)	(4.524)	(0.109)	(4.194)	(0.182)	(3.331)	(2.799)	(3.201)
ln(Size)	0.261***	0.249***	0.256***	0.236***	0.183***	0.258***	0.222***	0.244***	0.108**	0.254***	0.108***	0.259***	0.303***	0.245***
	(10.920)	(10.844)	(13.777)	(9.105)	(6.650)	(14.644)	(8.370)	(13.937)	(2.338)	(14.724)	(3.423)	(12.905)	(11.707)	(14.106)
ln(Age)	0.083*	0.078*	0.074**	0.053	0.031	0.073**	-0.027	0.096***	0.117	0.061*	0.076*	0.033	0.038	0.057*
	(1.779)	(1.869)	(2.260)	(1.474)	(0.518)	(2.249)	(-0.516)	(2.943)	(1.103)	(1.890)	(1.764)	(0.871)	(0.763)	(1.732)
ROA	0.325	0.542*	-0.059	0.795**	0.303	0.631**	0.262	0.460*	-0.068	0.591**	-0.302	1.033***	-0.069	0.800***
	(0.882)	(1.707)	(-0.225)	(2.372)	(0.748)	(2.221)	(0.705)	(1.677)	(-0.138)	(2.158)	(-0.969)	(2.795)	(-0.162)	(3.183)
Leverage	-0.015	-0.119	-0.351***	-0.272**	0.069	-0.048	0.106	-0.066	0.021	-0.023	0.125	-0.029	-0.143	-0.093
	(-0.100)	(-0.902)	(-3.093)	(-2.225)	(0.367)	(-0.405)	(0.526)	(-0.591)	(0.081)	(-0.200)	(0.887)	(-0.203)	(-0.631)	(-0.894)
Capex	-0.609	-0.447	-1.252**	-0.534	0.345	-0.855	-1.096	-0.491	1.741**	-0.789	-0.040	-1.167*	1.018	-1.155**
	(-0.609)	(-0.745)	(-2.345)	(-1.122)	(0.454)	(-1.569)	(-1.106)	(-1.003)	(2.048)	(-1.502)	(-0.067)	(-1.672)	(1.001)	(-2.157)
Cash	-0.867***	-0.415*	-0.961***	-0.242	-0.474*	-0.453**	-0.693**	-0.373**	-0.384	-0.468**	-0.040	-0.693***	-0.257	-0.678***
	(-3.851)	(-1.821)	(-5.617)	(-0.920)	(-1.935)	(-2.174)	(-2.012)	(-2.033)	(-1.412)	(-2.389)	(-0.222)	(-2.800)	(-0.541)	(-4.008)
Market to Book	-0.001	-0.012***	-0.002	-0.004	-0.005	-0.005	-0.005	-0.005	0.005	-0.007**	0.005	-0.007*	-0.006	-0.005**
	(-0.340)	(-2.737)	(-0.560)	(-1.104)	(-0.715)	(-1.584)	(-1.032)	(-1.572)	(0.789)	(-2.285)	(1.076)	(-1.728)	(-1.243)	(-2.009)
Volatility	0.317**	0.111	0.251*	0.429***	0.143	0.228	0.195	0.178	-0.182	0.226*	0.130	0.195	-0.343**	0.348**
	(2.086)	(0.737)	(1.702)	(2.954)	(0.961)	(1.637)	(1.012)	(1.333)	(-0.807)	(1.785)	(0.883)	(1.020)	(-1.971)	(2.501)
Return	0.055	0.028	0.064**	-0.061*	0.117***	0.001	0.086	0.032	0.013	0.025	-0.008	0.033	0.026	0.052*
	(1.539)	(0.836)	(2.246)	(-1.710)	(2.611)	(0.038)	(1.472)	(1.298)	(0.233)	(1.039)	(-0.190)	(0.991)	(0.473)	(1.951)
Inst. Ownership	-0.060	0.176	-0.113	0.065	0.208	-0.024	-0.122	0.066	0.154	0.045	0.261*	-0.106	0.101	0.041
	(-0.384)	(1.050)	(-0.960)	(0.434)	(1.123)	(-0.184)	(-0.589)	(0.520)	(0.896)	(0.353)	(1.816)	(-0.667)	(0.547)	(0.330)
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
p-value (High≠Low)	0.057		0.018		0.006		0.015		0.289		0.161		0.402	
N	3,077	4,692	5,307	2,636	2,033	6,665	1,497	7,164	715	8,087	1,694	3,762	2,119	6,099
Adjusted R^2	0.382	0.318	0.381	0.322	0.312	0.347	0.342	0.334	0.411	0.336	0.194	0.338	0.387	0.333

Note: This table reports the results from regressions using sub-samples based on proxies for CEOs' equity incentives and outside options. Across all columns, the dependent variable is *ln(Number of Penalties$_{t+1}$)*, the main independent variable of interest is *Distraction*, and we include the same set of firm controls as in the baseline tests, as well as year and industry fixed effects (based on the Fama-French 48 industry classification). Columns (1) and (2) report the results from a sample split based on *GAI* (Custódio et al., 2013), where the sixth decile is used as a threshold. Columns (3) and (4) report the results from a sample split based on *MA Score* (Demerjian et al., 2012), where the first tercile is used as a threshold. Columns (5) and (6) report the results from a sample split based on *CEO tenure*, where the top quartile is used as a threshold. Columns (7) and (8) report the results from a sample split based on *CEO Age*, where the top quintile is used as a threshold. Columns (9) and (10) report the results from a sample split based on *CEO Founder*, which is a dummy variable that equals one if the CEO is the company founder. Columns (11) and (12) report the results from a sample split based on *CEO Ownership*, which is the percentage of company shares owned by the CEO. The seventh decile is used a threshold for this sample split. Columns (13) and (14) report the results from a sample split based on *Vega Delta Ratio*, which is defined as CEO vega divided by CEO delta. The top quartile is used as a threshold for this sample split. All variables are defined in Table A1 in the Appendix. Below the coefficient estimates, we report t-statistics in parentheses based on standard errors clustered by firm. The following significance levels are indicated by asterisks: *** (1 %), ** (5 %), * (10 %).

Table 6: Internal Governance, Institutional Investor Distraction, and Corporate Misconduct

	ln(Number of Penalties$_{t+1}$)					
	Governance Index		Board Size		Board Independence	
	High	Low	High	Low	High	Low
	(1)	(2)	(3)	(4)	(5)	(6)
Distraction	2.143***	-0.940	1.359***	-1.108	0.530	1.683***
	(3.091)	(-0.693)	(2.956)	(-1.055)	(0.917)	(3.032)
ln(Size)	0.279***	0.295***	0.272***	0.197***	0.290***	0.228***
	(10.647)	(7.331)	(13.495)	(6.598)	(12.907)	(9.418)
ln(Age)	0.062	-0.025	0.066*	0.027	0.020	0.094**
	(1.247)	(-0.297)	(1.652)	(0.574)	(0.457)	(2.153)
ROA	0.167	1.171**	0.396	0.309	0.461	0.237
	(0.365)	(2.116)	(1.274)	(0.808)	(1.303)	(0.756)
Leverage	0.023	-0.233	-0.244*	-0.003	-0.304*	-0.066
	(0.094)	(-0.872)	(-1.829)	(-0.017)	(-1.849)	(-0.483)
Capex	-0.265	1.712	-0.306	-0.521	-0.611	0.004
	(-0.279)	(1.127)	(-0.475)	(-0.774)	(-0.854)	(0.006)
Cash	-0.410	-0.688*	-0.691***	-0.562**	-0.325	-0.796***
	(-1.236)	(-1.866)	(-3.048)	(-2.350)	(-1.321)	(-3.260)
Market to Book	-0.012**	-0.013	-0.005	-0.010	-0.004	-0.012***
	(-2.011)	(-1.589)	(-1.586)	(-1.170)	(-1.263)	(-2.973)
Volatility	0.391*	-0.410	0.070	0.111	0.028	0.102
	(1.930)	(-1.210)	(0.518)	(0.468)	(0.163)	(0.674)
Return	0.006	0.077	0.020	0.013	0.009	0.039
	(0.112)	(0.964)	(0.673)	(0.201)	(0.226)	(1.122)
Inst. Ownership	0.120	0.232	0.085	0.327**	-0.179	0.234
	(0.650)	(0.919)	(0.528)	(2.080)	(-0.974)	(1.287)
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
p-value (High≠Low)	0.035		0.023		0.137	
N	2,000	568	5,878	918	3,150	3,644
Adjusted R^2	0.344	0.494	0.351	0.266	0.411	0.304

Note: This table reports the results from regressions using sub-samples based on proxies for the firm's internal governance structure. Across all columns, the dependent variable is *ln(Number of Penalties$_{t+1}$)*, the main independent variable of interest is *Distraction*, and we include the same set of firm controls as in the baseline tests, as well as year and industry fixed effects (based on the Fama-French 48 industry classification). Columns (1) and (2) report the results from a sample split based on the *Governance Index*, which is the corporate governance index provided by Gompers et al. (2003). The first quartile is used as a threshold for this sample split. Columns (3) and (4) report the results from a sample split based on *Board Size*, which corresponds to the number of directors on the firm's board. The first quartile is used as a threshold for this sample split. Columns (5) and (6) report the results from a sample split based on *Board Independence*, which is the proportion of directors that are independent. The median is used as a threshold for this sample split. All variables are defined in Table A1 in the Appendix. Below the coefficient estimates, we report t-statistics in parentheses based on standard errors clustered by firm. The following significance levels are indicated by asterisks: *** (1 %), ** (5 %), * (10 %).

Table 7: External Governance, Institutional Investor Distraction, and Corporate Misconduct

	ln(Number of Penalties$_{t+1}$)			
	Analysts		# Disclosure Views	
	High	Low	High	Low
	(1)	(2)	(3)	(4)
Distraction	-0.290	1.173***	0.134	1.208***
	(-0.507)	(3.023)	(0.164)	(3.096)
ln(Size)	0.363***	0.232***	0.272***	0.220***
	(10.021)	(14.921)	(8.005)	(13.440)
ln(Age)	0.085	0.055**	0.141**	0.023
	(1.464)	(2.076)	(2.251)	(0.928)
ROA	1.191***	0.335	-0.096	0.663***
	(2.643)	(1.472)	(-0.198)	(2.834)
Leverage	0.168	-0.083	0.220	-0.128
	(0.835)	(-0.861)	(1.110)	(-1.335)
Capex	-1.147	0.013	-0.683	-0.310
	(-1.351)	(0.033)	(-0.731)	(-0.765)
Cash	-0.451	-0.084	-0.469	-0.323**
	(-1.568)	(-0.538)	(-1.341)	(-2.062)
Market to Book	-0.001	-0.004	0.002	-0.005*
	(-0.323)	(-1.484)	(0.420)	(-1.692)
Volatility	-0.131	0.359***	-0.222	0.215**
	(-0.699)	(3.126)	(-1.083)	(1.981)
Return	0.038	0.005	0.035	0.046**
	(0.747)	(0.225)	(0.669)	(2.033)
Inst. Ownership	0.434*	0.106	0.041	0.089
	(1.663)	(1.229)	(0.156)	(0.994)
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
p-value (High≠Low)	0.035		0.224	
N	2,337	7,526	1,619	6,639
Adjusted R^2	0.441	0.283	0.437	0.256

Note: This table reports the results from regressions using sub-samples based on proxies for external governance mechanisms. Across all columns, the dependent variable is *ln(Number of Penalties$_{t+1}$)*, the main independent variable of interest is *Distraction*, and we include the same set of firm controls as in the baseline tests, as well as year and industry fixed effects (based on the Fama-French 48 industry classification). Columns (1) and (2) report the results from a sample split based on *Analysts*, which is the number of analysts following the firm. The top quartile is used as a threshold for this sample split. Columns (3) and (4) report the results from a sample split based on *#Disclosure Views*, which is the aggregated number of unique daily clicks on corporate disclosures according to the SEC EDGAR server log files. The top quintile is used as a threshold for this sample split. All variables are defined in Table A1 in the Appendix. Below the coefficient estimates, we report t-statistics in parentheses based on standard errors clustered by firm. The following significance levels are indicated by asterisks: *** (1 %), ** (5 %), * (10 %).

Table 8: Institutional Investor Distraction and Different Categories of Corporate Misconduct

Dependent Variable: *ln(Number of Penalties$_{t+1,Group}$)*				
	Consumer (1)	Employment (2)	Environment (3)	Safety (4)
Distraction	0.264**	0.490***	0.397**	0.562**
	(2.075)	(3.001)	(2.088)	(2.196)
Controls	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes
N	9,887	9,887	9,887	9,887
Adjusted R^2	0.378	0.148	0.311	0.301

Note: This table reports the results from regressions where the dependent variable is the natural logarithm of one plus the number of violations related to four different offense groups (*ln(Number of Penalties$_{t+1,Group}$)*). The main independent variable of interest is *Distraction*. All regressions include industry fixed effects (based on the Fama-French 48 industry classification), year fixed effects, and the same set of firm controls as in our baseline regressions. The coefficient estimates for these control variables are not reported for reasons of brevity. All variables are defined in Table A1 in the Appendix. Below the coefficient estimates, we report t-statistics in parentheses based on standard errors clustered by firm. The following significance levels are indicated by asterisks: *** (1 %), ** (5 %), * (10 %).

Online Appendix – Institutional Investor Distraction and Unethical Business Practices: Evidence from Stakeholder-Related Misconduct

In this online appendix, we report the results from several additional robustness tests that we do not show in the paper for reasons of brevity.

A. Alternative Fixed Effects Structures

While our baseline regressions include industry and year fixed effects and we also use a first-difference analysis to rule out time-invariant heterogeneity, we test whether the results persist when reestimating our regressions using alternative fixed effects structures. Specifically, we test whether the results are robust to including state fixed effects, state-by-year fixed effects, industry-by-year fixed effects, and firm fixed effects. Table S1 displays the results. Panel A reports the results where the main independent variable of interest is *Distraction*. The results show that we find positive and significant coefficients across all columns, even in columns (4) and (5) where we include firm fixed effects. We also find similar results in Panel B, where the main independent variable of interest is *Distraction Dummy*. This suggests using alternative fixed effects structures does not affect our results.

Table S1: Alternative Fixed Effects

Panel A:	ln(Number of Penalties$_{t+1}$)				Number of Penalties$_{t+1}$
	(1)	(2)	(3)	(4)	(5)
Distraction	1.282***	1.444***	2.415***	0.424*	1.023**
	(3.871)	(3.955)	(2.891)	(1.669)	(2.267)
Controls	Yes	Yes	Yes	Yes	Yes
State FE	Yes	No	No	No	No
State × Year FE	No	Yes	No	No	No
Industry FE	Yes	Yes	No	No	No
Industry × FE	No	No	Yes	No	No
Firm FE	No	No	No	Yes	Yes
Year FE	Yes	No	No	Yes	Yes
Estimator	OLS	OLS	OLS	OLS	PPML
N	9,856	9,724	9,816	9,851	9,840
(Pseudo) Adjusted R^2	0.348	0.331	0.314	0.649	0.561

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Panel B:	ln(Number of Penalties$_{t+1}$)				Number of Penalties$_{t+1}$
	(1)	(2)	(3)	(4)	(5)
Distraction Dummy	0.091***	0.094***	0.132***	0.045**	0.075***
	(4.215)	(4.025)	(3.711)	(2.559)	(2.741)
Controls	Yes	Yes	Yes	Yes	Yes
State FE	Yes	No	No	No	No
State × Year FE	No	Yes	No	No	No
Industry FE	Yes	Yes	No	No	No
Industry × FE	No	No	Yes	No	No
Firm FE	No	No	No	Yes	Yes
Year FE	Yes	No	No	Yes	Yes
Estimator	OLS	OLS	OLS	OLS	PPML
N	9,856	9,724	9,816	9,851	9,840
(Pseudo) Adjusted R^2	0.348	0.331	0.314	0.649	0.561

Note: Panel A of this table reports the results from regressions where the dependent variable is either *ln(Number of Penalties$_{t+1}$)* or *Number of Penalties$_{t+1}$*, and where the main independent variable of interest is *Distraction*. Across all columns, we include the same set of control variables as in our baseline regressions in the paper. Panel B reports the results from similar regressions using *Distraction Dummy* as the main independent variable. Below the coefficient estimates, we report t-statistics in parentheses based on standard errors clustered by firm. The following significance levels are indicated by asterisks: *** (1 %), ** (5 %), * (10 %).

B. Alternative Clustering of Standard Errors

Throughout the paper, we cluster standard errors by firm. To test robustness of our results, we also cluster standard errors by industry or by industry and year. The results from our baseline regressions are displayed in Table S2. Panel A reports the results using OLS, while Panel B reports the results using PPML. As can be seen, regardless of how we cluster standard errors, the relationship is still significant.

Table S2: Alternative Clustering of Standard Errors

Panel A: OLS	ln(Number of Penalties$_{t+1}$)	
	(1)	(2)
Distraction	1.312**	1.312**
	(2.378)	(2.609)
Controls	Yes	Yes
Industry FE	Yes	Yes
Year FE	Yes	Yes
Clustering	Industry	Industry, Year
N	9,887	9,887
Adjusted R^2	0.322	0.322

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Panel B: PPML	Number of Penalties$_{t+1}$	
	(1)	(2)
Distraction	1.798**	1.798**
	(2.018)	(2.116)
Controls	Yes	Yes
Industry FE	Yes	Yes
Year FE	Yes	Yes
Clustering	Industry	Industry, Year
N	9,887	9,887
Pseudo R^2	0.347	0.347

Note: Panel A of this table reports the results from OLS regressions where the dependent variable is *ln(Number of Penalties$_{t+1}$)* and the main independent variable of interest is *Distraction*. Across all columns, we include the same set of control variables as in our baseline regressions in the paper. Panel B reports the results from similar PPML regressions using *Number of Penalties$_{t+1}$* as the dependent variable. Below the coefficient estimates, we report t-statistics in parentheses based on standard errors clustered by industry (column (1)) or by industry and year (column (2)). The following significance levels are indicated by asterisks: *** (1 %), ** (5 %), * (10 %).

C. Additional Control Variables

Although the regressions reported in the paper include several firm-level control variables and our main measure is by construction exogenous, we further rule out concerns related to omitted variable bias by reestimating our regressions including additional control variables. Panel A of Table S3 reports the results from OLS regressions including these control variables, while Panel B displays the results from similar PPML regressions. In column (1), we add further firm-level controls variables. These include the firm's property, plant and equipment scaled by total assets (*Property*), the firm's intangible assets scaled by total assets (*Intangibles*), the firm's research and development expenses scaled by total assets (*R&D*), the firm's sales growth from year $t-1$ to year t (*Sales Growth*), the firm's abnormal earnings (*Abnormal Earnings*), and the natural logarithm of the firm's business segments (*ln(Segments)*). As can be seen, the coefficients on *Distraction* remain positive and significant in both panels.

Column (2) reports the results from regression where we add the firm's social score (*S Score*), environmental score (*E Score*), and governance score (*G Score*). The data on

these scores are obtained from Thomson Reuters Eikon. The results show that including these scores does not have a significant effect on the coefficient on *Distraction*.

Column (3) displays the results from regressions including the natural logarithm of one plus the number of analysts following the firm (*ln(Analysts)*). But as the results show, this does not affect our main findings.

Column (4) documents the results from regressions including additional board controls obtained from BoardEx. Specifically, we include the board size (*Board Size*), the mean age of the directors on the firm's board (*Board Age*), the mean tenure of the directors on the firm's board (*Board Tenure*), and the proportion of independent directors on the firm's board (*Board Independence*). We note that this does not affect our main findings qualitatively since the coefficients on *Distraction* remain positive and significant.

Finally, column (5) shows the results from regressions including additional CEO controls obtained from Execucomp, i.e., the CEO's age (*CEO Age*), the CEO's tenure (*CEO Tenure*), a dummy variable indicating the CEO's gender (*CEO Gender*), and a dummy variable indicating whether the CEO is also the chairman of the board (*CEO Duality*). The results suggest that including these control variables does not affect our findings regarding the relationship between institutional distraction and stakeholder-related misconduct.

Table S3: Additional Control Variables

Panel A: OLS	ln(Number of Penalties$_{t+1}$)				
	(1)	(2)	(3)	(4)	(5)
Distraction	1.125***	1.482***	1.323***	1.111***	1.355***
	(2.952)	(2.811)	(3.945)	(2.626)	(3.713)
Property	0.376***				
	(4.219)				
Intangibles	0.088				
	(0.621)				
R&D	-4.053***				
	(-5.088)				
Sales Growth	0.153***				
	(2.936)				
Abnormal Earnings	0.005				
	(0.874)				
ln(Segments)	0.025				
	(0.688)				
S Score		-0.002			
		(-1.543)			
E Score		0.003**			
		(2.368)			
G Score		0.002*			
		(1.860)			
ln(Analysts)			-0.055**		
			(-2.376)		
Board Size				0.000	
				(0.013)	
Board Age				0.025***	
				(4.054)	
Board Tenure				-0.018***	
				(-2.794)	
Board Independence				-0.030	
				(-0.206)	
CEO Age					0.006**
					(2.233)
CEO Tenure					-0.007**
					(-2.229)
CEO Gender					0.069
					(0.808)
CEO Duality					0.026
					(0.846)
Controls	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes
N	7,632	3,624	9,863	6,794	8,564
Adjusted R^2	0.311	0.360	0.324	0.351	0.332

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Panel B: PPML	Number of Penalties$_{t+1}$				
	(1)	(2)	(3)	(4)	(5)
Distraction	1.826**	2.101**	1.816***	1.330*	1.784***
	(2.346)	(2.422)	(2.993)	(1.673)	(2.713)
Property	0.728***				
	(3.852)				
Intangibles	0.418				
	(1.048)				
R&D	-9.002***				
	(-3.263)				
Sales Growth	0.207**				
	(2.108)				
Abnormal Earnings	0.029**				
	(2.021)				
ln(Segments)	0.034				
	(0.424)				
S Score		-0.003			
		(-1.097)			
E Score		0.004			
		(1.462)			
G Score		0.004***			
		(2.798)			
ln(Analysts)			-0.034		
			(-0.877)		
Board Size				-0.019	
				(-1.035)	
Board Age				0.048***	
				(4.074)	
Board Tenure				-0.031**	
				(-2.567)	
Board Independence				-0.160	
				(-0.555)	
CEO Age					0.010**
					(2.050)
CEO Tenure					-0.013*
					(-1.954)
CEO Gender					0.065
					(0.284)
CEO Duality					0.063
					(1.009)
Controls	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes
N	7,632	3,624	9,863	6,794	8,564
Pseudo R^2	0.348	0.331	0.314	0.649	0.561

Note: Panel A of this table reports the results from OLS regressions where the dependent variable is *ln(Number of Penalties$_{t+1}$)* and the main independent variable of interest is *Distraction*. Across all columns, we include the same set of control variables as in our baseline regressions in the paper as well as the additional control variables shown. Panel B reports the results from similar regressions using the PPML estimator and *Number of Penalties$_{t+1}$* as the dependent variable. Below the coefficient estimates, we report t-statistics in parentheses based on standard errors clustered by firm. The following significance levels are indicated by asterisks: *** (1 %), ** (5 %), * (10 %).

D. Alternative Sample Selection

Consistent with prior literature (see e.g., Zaman et al., 2021, 2022), we run our regressions throughout the paper on a sample including financial and utility firms. We address the concern that these firms may drive our results by rerunning our baseline regressions excluding these firms. Table S4 reports the results. As can be seen, the results remain unchanged.

Table S4: Excluding Financial and Utiltity Firms

	ln(Number of Penalties$_{t+1}$)	Number of Penalties$_{t+1}$
	(1)	(2)
Distraction	1.398***	1.939**
	(3.048)	(2.287)
Controls	Yes	Yes
Industry FE	Yes	Yes
Year FE	Yes	Yes
Estimator	OLS	PPML
N	7,997	7,997
(Pseudo) Adjusted R^2	0.351	0.389

Note: This table reports the results from regressions where the dependent variable is either *ln(Number of Penalties$_{t+1}$)* or *Number of Penalties$_{t+1}$*, and where the main independent variable of interest is *Distraction*. Across all columns, we include the same set of control variables as in our baseline regressions in the paper. Below the coefficient estimates, we report t-statistics in parentheses based on standard errors clustered by firm. The following significance levels are indicated by asterisks: *** (1 %), ** (5 %), * (10 %).

Further, to rule out that the years of the financial crisis (2008–2009) might affect our results since they might be associated with more cases of misconduct, we rerun our baseline tests on a sample excluding these years. We display the results from these regressions in Table S5. The results suggest that excluding the years of the financial crisis does not affect our main findings.

Table S5: Excluding Financial Crisis

	ln(Number of Penalties$_{t+1}$)	Number of Penalties$_{t+1}$
	(1)	(2)
Distraction	1.410***	2.184***
	(3.837)	(3.222)
Controls	Yes	Yes
Industry FE	Yes	Yes
Year FE	Yes	Yes
Estimator	OLS	PPML
N	8,621	8,621
(Pseudo) Adjusted R^2	0.321	0.341

Note: This table reports the results from regressions where the dependent variable is either *ln(Number of Penalties$_{t+1}$)* or *Number of Penalties$_{t+1}$*, and where the main independent variable of interest is *Distraction*. Across all columns, we include the same set of control variables as in our baseline regressions in the paper. Below the coefficient estimates, we report t-statistics in parentheses based on standard errors clustered by firm. The following significance levels are indicated by asterisks: *** (1 %), ** (5 %), * (10 %).

Furthermore, for the regressions in the paper, we employ a sample where we set the number of violations and the resulting penalties to zero for firm-years not included in the Violation Tracker Database between the first and last violation; however, to test whether this affects our results, we rerun the regressions using a larger sample where we set the number of violations and the resulting penalties to zero for all firm-years between 2000 and 2017 that were not included in the Violation Tracker Database. Table S6 displays the results. As can be seen, this does not qualitatively affect our findings.

Table S6: Larger Sample

	ln(Number of Penalties$_{t+1}$)	Number of Penalties$_{t+1}$
	(1)	(2)
Distraction	0.986***	1.575***
	(3.429)	(2.580)
Controls	Yes	Yes
Industry FE	Yes	Yes
Year FE	Yes	Yes
Estimator	OLS	PPML
N	12,553	12,553
(Pseudo) Adjusted R^2	0.317	0.345

Note: This table reports the results from regressions where the dependent variable is either *ln(Number of Penalties$_{t+1}$)* or *Number of Penalties$_{t+1}$*, and where the main independent variable of interest is *Distraction*. Across all columns, we include the same set of control variables as in our baseline regressions in the paper. Below the coefficient estimates, we report t-statistics in parentheses based on standard errors clustered by firm. The following significance levels are indicated by asterisks: *** (1 %), ** (5 %), * (10 %).

E. Interaction Terms Instead of Sample Splits

In the paper, we use sample splits to investigate whether CEOs are more likely to commit misconduct when they have stronger equity incentives or more outside options in the executive labor market. However, to test robustness, we also run regressions with interaction terms between our main measure of institutional distraction and the seven proxies used in the paper. Table S7 shows the results. We find that they strongly support the findings in the paper, i.e., the effect is stronger (weaker) when managers have stronger (weaker) equity incentives and more (less) outside options. In fact, we even find significant coefficients on the interaction terms in columns (5) and (7), where we interact *Distraction* with *CEO Founder* and *High Vega Delta*, respectively. This is something we did not find using the sample splits, but is consistent with our argumentation.

Table S7: Interaction Terms

	ln(Number of Penalties$_{t+1}$)						
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Distraction	0.921**	0.872	1.648***	1.624***	1.552***	1.553***	1.291***
	(2.176)	(1.515)	(4.314)	(4.418)	(4.262)	(3.379)	(3.434)
High GAI	-0.255***						
	(-3.363)						
High GAI×Distraction	1.396***						
	(3.077)						
High MA Score		-0.103					
		(-1.388)					
High MA Score×Distraction		0.776*					
		(1.672)					
High CEO Tenure			0.138				
			(1.596)				
High CEO Tenure×Distraction			-1.026**				
			(-1.984)				
High CEO Age				0.237**			
				(2.252)			
High CEO Age×Distraction				-1.516**			
				(-2.470)			
CEO Founder					0.266*		
					(1.816)		
CEO Founder×Distraction					-1.944**		
					(-2.066)		
High CEO Ownership						0.113	
						(1.146)	
High CEO Ownership×Distraction						-0.970	
						(-1.563)	
High Vega Delta Ratio							-0.121
							(-1.484)
High Vega Delta Ratio×Distraction							0.809*
							(1.718)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	No	No	No	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	7,769	7,943	8,698	8,664	8,804	5,453	8,219
Adjusted R^2	0.336	0.353	0.331	0.329	0.330	0.310	0.345

Note: This table reports the results from regressions where the dependent variable is *ln(Number of Penalties$_{t+1}$)* and where the main independent variable of interest is *Distraction*. The interaction terms are based on the same proxies for CEO equity incentives and outside options as in the paper. Across all columns, we include the same set of control variables as in our baseline regressions in the paper. Below the coefficient estimates, we report t-statistics in parentheses based on standard errors clustered by firm. The following significance levels are indicated by asterisks: *** (1 %), ** (5 %), * (10 %).

F. Sample Splits for the Dimension-Regressions

Finally, we also report the results from sample splits based on our proxies for CEO equity incentives and outside options employing dependent variables calculated using only the violations related to each offense group. Table S8 shows the results. Overall, they are consistent with Hypothesis II (but slightly less pronounced).

Table S8: CEO Incentives & Outside Options, Institutional Investor Distraction, and Corporate Misconduct

Panel A: Consumer	Dependent Variable: *ln(Number of Penalties$_{t+1,Group}$)*													
	GAI		MA Score		CEO Tenure		CEO Age		CEO Founder		CEO Ownership		Vega Delta Ratio	
	High	Low	High	Low	High	Low	High	Low	=1	=0	High	Low	High	Low
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)
Distraction	0.574***	0.102	0.024	-0.253*	0.409	0.226	-0.566*	0.431***	-0.495	0.353***	0.385	0.301*	0.600*	0.200
	(2.765)	(0.488)	(0.163)	(-1.734)	(1.162)	(1.474)	(-1.750)	(2.866)	(-0.858)	(2.587)	(0.745)	(1.688)	(1.830)	(1.258)
Controls & FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
p-value (High≠Low)	0.110		0.159		0.633		0.004		0.1364		0.877		0.275	
N	3,076	4,692	5,307	2,636	2,033	6,665	1,497	7,164	715	8,087	1,690	3,758	2,119	6,099
Adjusted R^2	0.387	0.430	0.192	0.124	0.398	0.409	0.489	0.393	0.217	0.423	0.351	0.427	0.426	0.411
Panel B: Employment														
Distraction	0.446	0.532**	0.942***	-0.171	0.050	0.584***	0.158	0.588***	0.973	0.480***	0.197	0.396*	1.044***	0.340
	(1.571)	(2.288)	(3.571)	(-0.390)	(0.153)	(2.726)	(0.461)	(2.861)	(1.598)	(2.596)	(0.505)	(1.654)	(2.751)	(1.635)
Controls & FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
p-value (High≠Low)	0.806		0.022		0.168		0.270		0.416		0.657		0.093	
N	3,076	4,692	5,307	2,636	2,033	6,665	1,497	7,164	715	8,087	1,690	3,758	2,119	6,099
Adjusted R^2	0.198	0.148	0.191	0.127	0.148	0.154	0.128	0.155	0.118	0.162	0.076	0.160	0.180	0.149
Panel C: Environment														
Distraction	0.944***	-0.099	0.767**	-0.247	0.228	0.433*	0.217	0.383*	-0.133	0.374*	0.101	0.196	0.863*	0.217
	(2.654)	(-0.374)	(2.426)	(-0.488)	(0.542)	(1.782)	(0.370)	(1.723)	(-0.212)	(1.734)	(0.261)	(0.718)	(1.783)	(0.912)
Controls & FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
p-value (High≠Low)	0.017		0.076		0.671		0.789		0.432		0.840		0.234	
N	3,076	4,692	5,307	2,636	2,033	6,665	1,497	7,164	715	8,087	1,690	3,758	2,119	6,099
Adjusted R^2	0.333	0.318	0.347	0.240	0.339	0.306	0.397	0.296	0.594	0.306	0.276	0.338	0.317	0.314
Panel D: Safety														
Distraction	1.333***	0.087	1.352***	0.170	-1.098*	1.092***	0.121	0.773**	-0.672	0.803***	-0.268	1.059***	0.441	0.754**
	(3.307)	(0.229)	(3.088)	(0.263)	(-1.903)	(3.575)	(0.222)	(2.376)	(-0.610)	(2.955)	(-0.342)	(2.911)	(0.895)	(2.351)
Controls & FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
p-value (High≠Low)	0.019		0.105		0.000		0.301		0.173		0.116		0.583	
N	3,076	4,692	5,307	2,636	2,033	6,665	1,497	7,164	715	8,087	1,690	3,758	2,119	6,099
Adjusted R^2	0.388	0.301	0.301	0.325	0.318	0.337	0.334	0.323	0.340	0.325	0.184	0.323	0.404	0.318

Note: This table reports the results from regressions using sub-samples based on the same set of proxies for CEO equity incentives and outside options as in the paper. Panel A shows the results using a dependent variable calculated based on consumer-protection-related offenses. Panel B shows the results using a dependent variable calculated based on employment-related offenses. Panel C shows the results using a dependent variable calculated based on environment-related offenses. Finally, Panel D shows the results using a dependent variable calculated based on safety-related offenses. Across all panels and columns, the regressions include the same set of control variables as in our baseline regressions in the paper, as well as industry and year fixed effects. Below the coefficient estimates, we report t-statistics in parentheses based on standard errors clustered by firm. The following significance levels are indicated by asterisks: *** (1 %), ** (5 %), * (10 %).

References

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