THE IMPACT OF CORPORATE MORAL HAZARD ON ESG PERFORMANCE OF THE U.S. MNCS: THE INTERACTION EFFECT OF TYPE OF OWNERSHIP

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by

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LIST OF ABBREVIATIONS

AUM	Assets Under Management
CDP	Carbon Disclosure Project
CDSB	Climate Disclosure Standards Board
CFP	Corporate Financial Performance
CG	Corporate Governance
CSP	Corporate Social Performance
CSR	Corporate Social Responsibility
CSRHub	Corporate Social Responsibility Hub
EPA	Environmental Protection Agency
ESG	Environmental, Social, and Governance
FGLS	Feasible Generalized Least Squares Model
FY	Fiscal Year
GRI	Global Reporting Initiative
IIRC	International Integrated Reporting Council
ISO	International Organization for Standardization
MNCs	Multi-National Corporations
SASB	Sustainability Accounting Standards Board
SEC	Security and Exchange Commission
S&P	Standard & Poor's
SUST	Sustainalytics
UN SDG	United Nations Sustainable Development Goals
US	United States
VT	Violation Tracker

IMPAK BAHAYA MORAL KORPORAT TERHADAP PRESTASI ESG DI MNC A.S.: KESAN INTERAKSI JENIS PEMILIKAN

ABSTRAK

Peningkatan dalam sekatan korporat dan nilai serta jumlah tindakan penguatkuasaan korporat terhadap syarikat menimbulkan persoalan tentang kesannya terhadap ESG performance. Literatur arus perdana mencadangkan bahawa bahaya moral korporat membawa kepada penurunan indeks ESG. Menggunakan data panel daripada 385 MNC A.S. selama lima tahun dari 2018 hingga 2022, kajian ini menganalisis kesan bahaya moral korporat ke atas ESG performance. Kajian ini juga mengkaji kesan interaksi struktur pemilikan terhadap hubungan antara risiko moral korporat, dinyatakan dalam nilai kasar dan kelantangan tindakan penguatkuasaan korporat, dan ESG performance. Struktur pemilikan dinyatakan melalui pemilikan institusi, pemilikan orang dalam, dan pemilikan keluarga. Kadar CSRHub digunakan untuk mewakili ESG performance dan penilaian Sustainalytics digunakan untuk tujuan yang lebih kukuh. Kajian ini menggunakan *Pooled Ordinary Least Square (POLS), Random Effect Model (REM), Fixed Effect Model (FEM)*, dan *Feasible Generalized Least Squares Model (FGLS)* yang boleh dilaksanakan untuk menganggarkan model asas dan interaksi. Penemuan menunjukkan bahawa, pertama bahaya moral korporat memberi kesan negatif kepada ESG performance. Kedua, saiz kes undang-undang korporat adalah proksi yang lebih ketara untuk bahaya moral korporat daripada jumlah tindakan penguatkuasaan. Ketiga, pemilik memainkan peranan penting dalam mengubah suai kesan terhadap bahaya moral korporat ke atas ESG performance. Keempat, keluarga adalah pemilik yang paling berpengaruh positif dari segi ESG performance. Lebih ramai pemilik keluarga mendorong penalti

yang lebih tinggi dan skor ESG serta mengurangkan saiz tindakan undang-undang, terutamanya, jika peratusan pemilikan melebihi nilai min. Kelima, orang dalam berinteraksi secara negatif dengan hubungan antara bahaya moral korporat dan ESG performance. Seterusnya, pemilik institusi meminimumkan jumlah tindakan penguatkuasaan, tetapi ia terkait dengan jenis hukuman yang berat. Lebih ramai orang dalam mengurangkan jumlah dalam kes undang-undang dan dapat melaksanakan kawalan yang ketara ke atas tindakan penguatkuasaan. Sebaliknya, pengurangan dapat mengakibatkan hukuman yang lebih berat dan meningkatkan tindakan undang-undang ke tahap tertentu. Akhirnya, mekanisme CG secara signifikan dan positif mempengaruhi ESG performance. Kajian ini adalah salah satu daripadanya untuk mengatasi masalah mengkaji sebahagian kesan litigasi korporat terhadap ESG performance. Kajian itu, menyumbang ke arah literatur bahaya moral korporat dari perspektif ini. Penemuan ini memberikan pandangan yang berguna kepada pengurus korporat dan penggubal dasar. Sebagai contoh, syarikat mesti memerhatikan penalti serta denda dan cuba sedaya upaya untuk mengurangkan nilai dan jumlah mereka. Kajian itu juga menyediakan maklumat kepada pengawal selia, pemilik dan pelabur tentang cara penalti boleh dikaitkan dengan ESG prestasi dan pematuhan syarikat.

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ABSTRACT

The increase in corporate sanctions and the value and volume of corporate enforcement actions against companies raises questions about their impact on ESG performance. Mainstream literature suggests that corporate moral hazard leads to ESG index plummets. Using panel data from 385 US MNCs for five years from 2018 to 2022, this study analyzes the impact of corporate moral hazard on ESG performance. The study also investigates the interaction effect of the ownership structure on the relationship between corporate moral hazard _ expressed in the gross value and volume of corporate enforcement actions _ and ESG performance. The ownership structure is expressed through institutional, insider, and family ownership. CSRHub's ratings are used to represent ESG performance. And Sustainalytics' ratings are used for robust purposes. The study applies Pooled Ordinary Least Square model (POLS), Random Effect Model (REM), Fixed Effect Model (FEM), and Feasible Generalized Least Squares Model (FGLS) to estimate the baseline and interaction models. The findings suggest that first, corporate moral hazard negatively impacts ESG performance. Second, the size of corporate lawsuits is a more pronounced proxy for corporate moral hazard than the amount of enforcement actions. Third, owners play a significant role in modifying the impact of the corporate moral hazard on ESG performance. Fourth, institutional owners minimize the amount of enforcement actions, but they are related to massive penalty types. Fifth, the insiders negatively interact with the association between the corporate

moral hazard and ESG performance. More insiders reduce the size of lawsuits and exert significant control over the amount of enforcement actions. Conversely, fewer of them result in heavier penalties and increase the lawsuits to a certain point. Sixth, families are the most positively influential owners in terms of ESG performance. More family owners induce higher penalties and ESG scores and reduce the size of lawsuits, especially if the ownership percentage exceeds the mean value. Finally, CG mechanisms significantly and positively affect ESG performance. This study is one of its kind to overcome the problem of partially studying corporate litigation's impact on ESG performance. The study, hence, attempted to contribute to corporate moral hazard literature from this perspective. The findings provide useful insights to corporate managers and policymakers. For instance, companies must keep an eye on penalties and fines and try their hardest to reduce their value and volume. The study also provides information to regulators, owners, and investors on how the penalties could be linked to both ESG performance and compliance of companies.

CHAPTER 1

INTRODUCTION

1.1   Introduction

The past decade witnessed a surge of business scandals that permeated the market Cole et al. (2021), Mthombeni (2021), and Antonetti et al. (2020), renewed focus on how these events impact the value of shareholders and the principles of corporate governance (CG), and reactions of stock market. These failures have brought to the forefront the necessity for regulators to reconsider their regulatory frameworks and enforcement strategies. Additionally, these failures serve as a warning to corporations, prompting them to reassess their organizational structures and evaluate their commitment to ethical business practices (Cole et al., 2021). Fraud, scandals, bribery, money laundering, and tax evasion, not to mention greenwashing and management misconduct are just a few types of offenses against companies. These corporate offenses have devastating consequences on micro- and macroeconomic scales.

The global value of bribery in 2021/2022 is estimated to be $1.75 trillion a year. That is more than 1% of the global "gross domestic product (GDP)". The risk of corruption and bribery cannot be considered in isolation. It often co-occurs with other financial crimes, especially fraud and money laundering (Kroll, 2022). The Forensic Services-Crowe Global released its report "The financial cost of fraud 2021", the latest data worldwide. The report reveals that the global losses of fraud account for 6.4% of GDP. That is 6.0% higher than in 2019. This equates to $5.38 trillion/£4.37 trillion. That is £3.89 trillion higher than in 2019. However, if losses were decreased by 40%, it would result in a release of more than £1.55 trillion,

which is a greater amount than the GDP of all but the seven biggest economies in the world (Gee & Button, 2021). The "Association of Certified Fraud Examiners" published the Global Study on Occupational Fraud and Abuse "Report to the Nations" (ACFE, 2020). According to that report from the largest organization dedicated to combating fraud worldwide, a typical fraud case lasts 14 months before detection (18 months in 2022). Further, it causes a loss of $8,300 a month. That results in a 5% estimated annual loss (which remains the same until 2022) of the organization's revenue with a $1,509,000 average loss per case. Out of all cases of occupational fraud, over 50% originated from four specific departments: executive/upper management 12%, accounting 14%, sales 11%, and operations 15%. Moreover, among different types of fraud schemes, financial statement fraud is the least frequent but incurs the highest costs. On the other hand, corruption emerged as the most prevalent scheme across all global regions. Importantly, the US and Canada have the highest fraud cases worldwide. According to (ACFE, 2010), fraud committed by owners or executives is three times more costly than management fraud and over nine times more costly than employee fraud. In 2022, they committed 23% of occupational frauds, leading to the largest losses. Detecting executive-level fraud is a considerably time-consuming process. Based on current data, the U.N. approximates that money laundering comprises 2% to 5% of the worldwide GDP, equating to an annual sum of $800 billion to $2 trillion laundered. Based on the U.N. University World Institute for Development Economics (UNU-WIDER), global individual tax evasion and multinational corporate profit-shifting cost $427 billion annually.

Based on this evidence, an increasing amount of research has explored the consequences of particular forms of corporate misconduct on both investors' wealth

and corporate performance. The findings indicate that companies experience a significant decrease in stock prices, debt ratings, and overall financial performance (FP) (Kuvvet, 2015; Jory et al., 2015; Mačaitytė & Virbašiūtė, 2018; Utz, 2019; Gam et al., 2021). More importantly, the existent literature on corporate offenses uses mostly one approach, which is the Event Study. Thus, the scarcity of research in this area, besides analyzing limited types of enforcement actions and resorting to a single approach of research, is the motivation to conduct this study.

In this regard, this study explores how corporate moral hazard affects the environmental, social, and governance performance (ESG performance). Additionally, it explores the interaction effect of ownership structure on ESG. Corporate moral hazard refers to all types of corporate offenses. This study investigates the total impact of all types of offenses under the moral hazard umbrella on ESG performance. The size of corporate lawsuits and the amount of enforcement actions represent a possible path that helps to reveal the corporate performance and the reliability of environmental, social, and Governance (ESG) ratings, and this is the main objective of this study. As the ownership structure affects both regulatory compliance and ESG performance, the study aims to answer the question: Does the enforcement action's impact on ESG performance depend on ownership structure?

1.2   Background of the Study

1.2.1   Corporate Moral Hazard

A moral hazard is an economic concept that describes a situation in a transaction where one party can engage in risky behavior, knowing that the other party will bear any negative consequences. This decision to take risks arises from an

information asymmetry, where one party possesses more information than the other. Moral hazard creates an economic problem by leading to an inefficient allocation of resources, as one party imposes higher costs on the other. When scaled up to a macro level, it can result in excessive costs for an entire economy. The term "moral hazard" derives from the moral implications involved in determining the right and wrong behavior of parties in a transaction. It can either lead to or prevent a hazard in which the party not engaging in the behavior might suffer the consequences. Moral hazard pertains to the inclination towards dishonesty or character flaws in individuals, which can increase the frequency or severity of losses. It is an inherent aspect of human behavior (Nakabayashi, 2006). Moral hazard is present in various economic domains. Here are several instances:

Firstly, the global financial crisis of 2007-2008 serves as a prime example of moral hazard within the banking sector. With lower interest rates, borrowers sought cheap loans from lenders who subsequently sold these loans to investors. However, when the Federal Reserve increased interest rates, the housing market collapsed. The defaulting of subprime mortgage holders on their loans led to the bankruptcy of both investors and banks. The government's efforts to minimize the resulting damage resulted in trillions of dollars in losses for the worldwide economy. Secondly, moral hazards can arise in workplace environments, particularly among employees. Individuals may exhibit moral hazard by taking less care of office equipment like laptops or company-provided incentives such as cars, as they know any damage will be covered by their employer. Thirdly, moral hazard can also emerge within insurance coverage. Under the assumption that insurance companies will bear the financial responsibility in the event of injury or property damage, policyholders may partake in hazardous activities (Pink, 2021). Finally, limited liability to the

shareholders of publicly listed private firms: changing the incentives for senior employees and majority shareholders may be the most effective form of listed firm regulation. Therefore, it is optimal to create a system where shareholders and managers are motivated to adhere to best practices to protect themselves and the company.

Literature on corporate moral hazard is developed in different fields including insurance, law, economics, accounting, finance, political economy, business, sociology, psychology, and criminology. Moral hazards may occur in banking, insurance, CG, healthcare systems, and other sectors. When it is transferred to the judicial authorities, it will be defined under the law acts issued, e.g., fraud, bribery, forgery, etc. Most corporate crimes result in financial losses and affect CP. In the US, it may lead the firms, in the worst case, to file for chapter 7 (liquidation bankruptcy), or chapter 11 (reorganization bankruptcy).

1.2.2   The US Corporate Moral Hazard

Corporate governance (CG) is still to blame after every wave of US corporate scandals. The scandals at Theranos and Ozy Media are just the latest in a lengthy line of scandals concerning reputable US public companies. The global financial crisis that occurred between 2008 and 2009 was triggered by the failure of prominent banks and the issues surrounding subprime mortgages. Further back in the1990s, the scandals at Enron, WorldCom, Qwest, and Tyco led to their demise. Consequently, policy makers raised questions about the effectiveness of CG mechanisms in companies. Thus, the Dodd-Frank Act of 2010 and the Sarbanes-Oxley Act of 2002 were issued to restrict and regulate corporate behavior. However, in the following years after imposing these regulations, episodes of CG failures continued, e.g.,

Dynegy (due to executives' fraud in 2022). Accounting failures, risky investments, and inefficient operations have proven to be disastrous for many giant US firms. This suggests that addressing CG issues concerning scandals is still worthwhile (Bhagat & Bolton, 2019). The securities market reflects and regulates CG standards. Many jurisdictions use securities markets as a tool to improve CG. The Securities and Exchange Commission (SEC) is responsible for enforcing regulations on companies under its jurisdiction, while the Department of Justice (DOJ) enforces the Act for individuals and domestic entities not regulated by the SEC. However, the actions taken by one agency do not prevent the other from initiating separate enforcement proceedings. There have been cases where both the DOJ and SEC have pursued enforcement actions against the same company for violating the Foreign Corrupt Practices Act (FCPA). In 2010, the SEC established a specialized unit dedicated to enforcing the FCPA. The SEC and DOJ jointly released the initial edition of their FCPA guide in 2012, followed by a second edition in 2020. The enforcement of the FCPA is a shared responsibility between the SEC and DOJ, as it amends both the SEC Act and the criminal code. However, the majority of companies face civil penalties, with criminal charges involved in less than half a percent of the cases (0.5%).

The Anti-Fraud Collaboration[1] report (2021) states that the US is the highest worldwide in terms of management misconduct in the period from 2014 to 2019 (AFC, 2021). In addition, workplace misconduct costs US companies $20 billion in 2020 (Forbes, 2021). As per the Association of Certified Fraud Examiners, it is estimated that fraudulent activities will result in an average loss of 5% of total

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[1] The formation of the Anti-Fraud Collaboration took place in October 2010, initiated by four esteemed US organizations: the Centre for Audit Quality (CAQ), The Institute of Internal Auditors (IIA), Financial Executives International (FEI), and the National Association of Corporate Directors (NACD).

revenues for companies in the US. The Summary of the Fraud Section[2] Corporate Resolutions (2020) involved the imposition of over $4.4 billion, $3.33 billion on FCPA, and $1.06 billion on MIMF which increased by 86% in 2022 (Fraud Section, 2021). In FY 2022, the ACFE's occupational fraud report states that the US and Canada cases are 675 (36% globally). In the same year, the defendants paid $149,312,313 in fines and restitution and forfeited $214,110,581 of illegal proceeds to EPA. In January 2020, Airbus SE, a multinational company specializing in civilian and military aircraft, reached an agreement to pay more than $3.9 billion as a settlement for charges related to foreign bribery (DOJ, 2020).

FY 2019 was a busy year for the SEC. In 2019, the enforcement activity of the SEC hits its second-highest level on record (Reuters, 2019). A total of 862 enforcement actions were led by the commission, with 526 of them being independent standalone actions, refer to Table 1.1. As per the annual report for the year 2019 from the Division of Enforcement of the SEC, more than $4.3 billion were collected due to disgorgement and penalties. Out of which, $1.2 billion were returned to harmed investors.

In FY 2020, the SEC conducted a wide array of 715 enforcement actions, with 405 of them being independent standalone actions. These actions covered a variety of significant issues, such as violations involving issuer disclosure and accounting, foreign bribery, investment advisory matters, securities offerings, market manipulation, insider trading, and broker-dealer misconduct. Consequently, the SEC obtained judgments and orders resulting in a record-breaking amount of $4.68 billion in disgorgement and penalties. Additionally, over $600 million was returned to

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[2] The Fraud Section - Criminal Division of the US Department of Justice publishes an annual review concerning three distinct litigation sectors: The Foreign Corrupt Practices Act Unit (FCPA), the Health Care Fraud Unit (HCF), and the Market Integrity and Major Frauds Unit (MIMF).

harmed investors. In FY 2022, there was a notable increase compared to the previous two years, as demonstrated in Table 1.2, with a 67% rise in enforcement actions compared to FY 2021.

Table 1.1   Size of Lawsuits 2017-2022

Enforcement Actions Filed in Fiscal Years 2017 to 2022						
	FY 2022	FY 2021	FY 2020	FY 2019	FY 2018	FY 2017
Standalone Enforcement Actions	462	434	405	526	490	446
Follow-On Admin Proceedings	169	143	180	210	210	196
Delinquent Filings	129	120	130	126	121	112
Total Actions	760	697	715	862	821	754

Source: (SEC, 2022)

Table 1.2   Amount of Enforcement Actions 2017-2022

Total Money Ordered (in millions)						
	FY 2022	FY 2021	FY 2020	FY 2019	FY 2018	FY 2017
Penalties	$4,194	$1,456	$1,091	$1,101	$1,439	$832
Disgorgement	$2,245	$2,395	$3,588	$3,248	$2,506	$2,957
Total	$6,439	$3,852	$4,680	$4,349	$3,945	$3,789

Source: (SEC, 2022)

Corporate enforcement actions in the US have been on the rise and are expected to continue increasing due to their prevalence in everyday life. In FY 2020, the SEC achieved unprecedented monetary remedies in its enforcement actions. Parties involved in the Commission's actions and proceedings were directed to pay a cumulative sum of $3.589 billion as disgorgement of unlawfully obtained profits. The penalties imposed amounted to $1.091 billion, aligning with the total penalty of $1.101 billion in FY 2019. The overall monetary relief ordered in FY 2020 exceeded that of the previous year by $330 million, representing an approximate 8% increase. In FY 2021, the SEC also obtained judgments and orders for $2.4 billion in disgorgement and over $1.4 billion in penalties. These figures denote a respective 33% decrease and 33% increase compared to the amounts ordered in the preceding

FY within these categories. However, the total monetary relief ordered in FY 2022 is nearly twice that of the previous year.

According to the SEED[3] report for FY 2021, there was a decline in the number of new enforcement actions against public companies and their subsidiaries, reaching the lowest count since 2014 with a total of 53 actions. This represents a 15% decrease from FY 2020 and a 32% decrease from the average of the previous five fiscal years, as depicted in Figure 1.1. Despite the reduced number of actions, the monetary settlements reached $1.8 billion, aligning with the average of $1.6 billion between FY 2013 and FY 2020. Notably, 51% of the actions involved allegations related to issuer reporting and disclosure, marking the first time in nearly a decade that more than half of the actions centered around this specific type of allegation (Choi, 2021). On the other hand, FY 2022 witnessed a 28% increase compared to the previous year.

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[3] The Securities Enforcement Empirical Database (SEED) monitors and logs data specifically related to SEC enforcement actions lodged against publicly traded companies listed on prominent US exchanges and their affiliated entities.
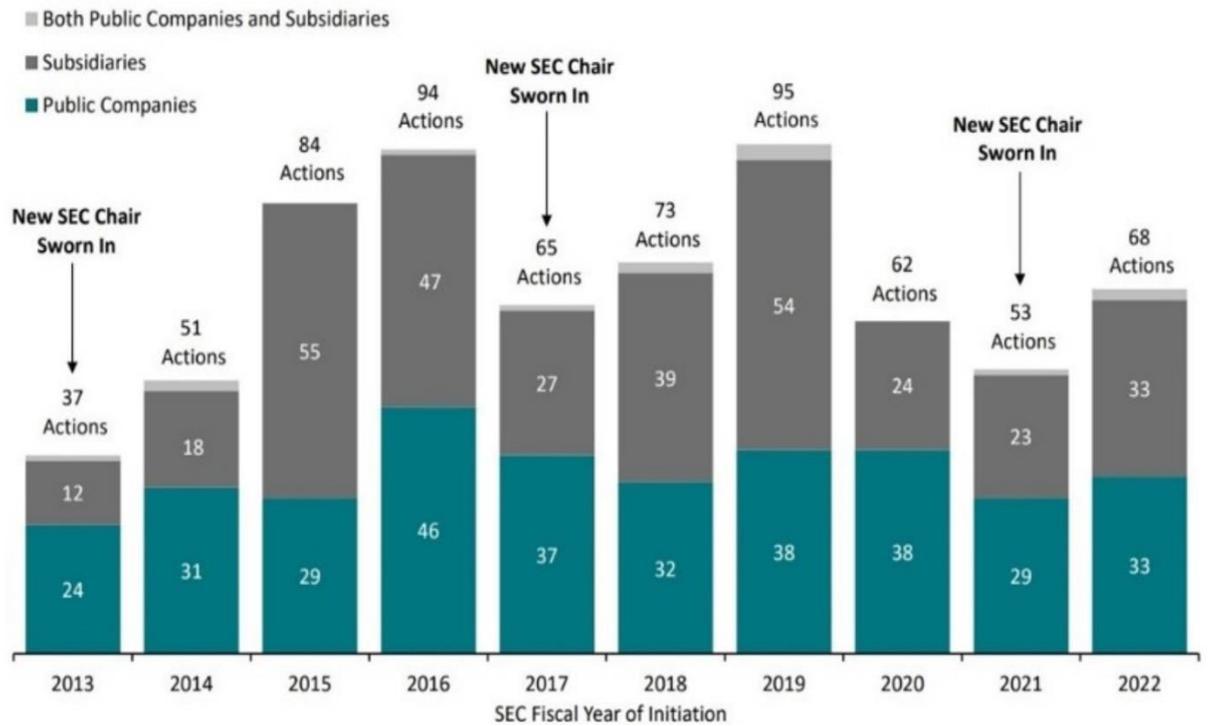
Source: (SEED, 2022)

Figure 1.1   Public Company Actions- Size of Lawsuits 2013-2022

In February 2020, the Office of Enforcement and Compliance Assurance US Environmental Protection Agency (EPA) published a comprehensive report for FY 2019. Based on the report, the EPA imposed federal administrative and civil judicial penalties that exceeded $360 million. This amount exceeds the annual penalty totals for all but three of the preceding ten years. Generally, the overall penalty assessments in a particular year are largely shaped by one or two major cases, as depicted in Figure 1.2.
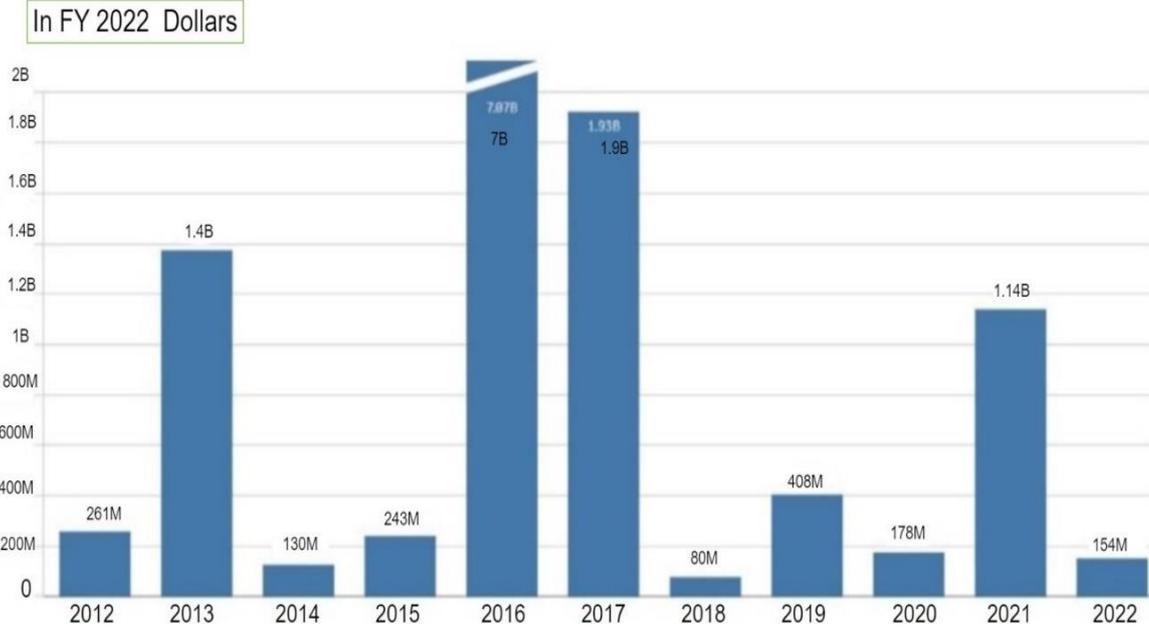
Figure 1.2   Administrative and Civil Judicial Penalties Assessed 2012-2022

During FY 2019, the combined sum of criminal fines, restitution, and court-ordered projects amounted to $111 million. However, in FY 2022, this total increased to $150 million, as shown in Figure 1.3.
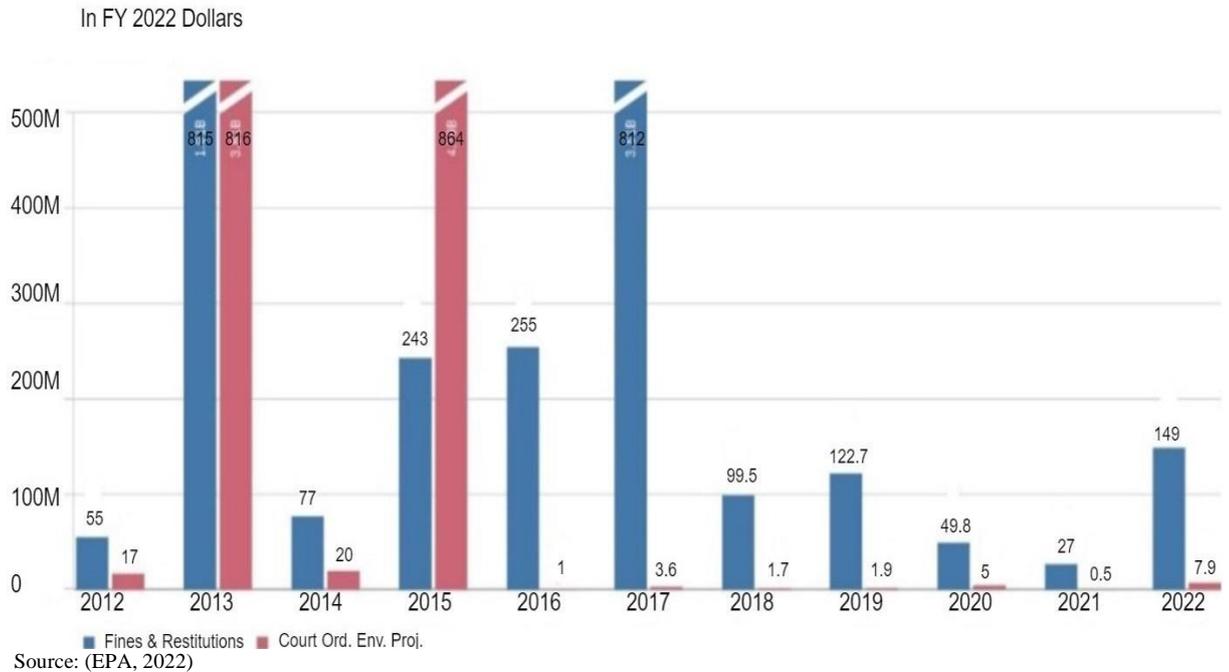
Figure 1.3   Criminal Enforcement Value of Environmental Cases 2012-2022

In line with the study objectives, Figure 1.4 and Figure 1.5 comprehensively depict the enforcement data for calendar 2022. The charts provide a visual representation of the patterns observed in the amount of enforcement sanctions and the size of corporate lawsuits initiated by the federal agencies mentioned in the charts over the past twenty years.

Source: (Committee on Capital Markets Regulation, 2022)
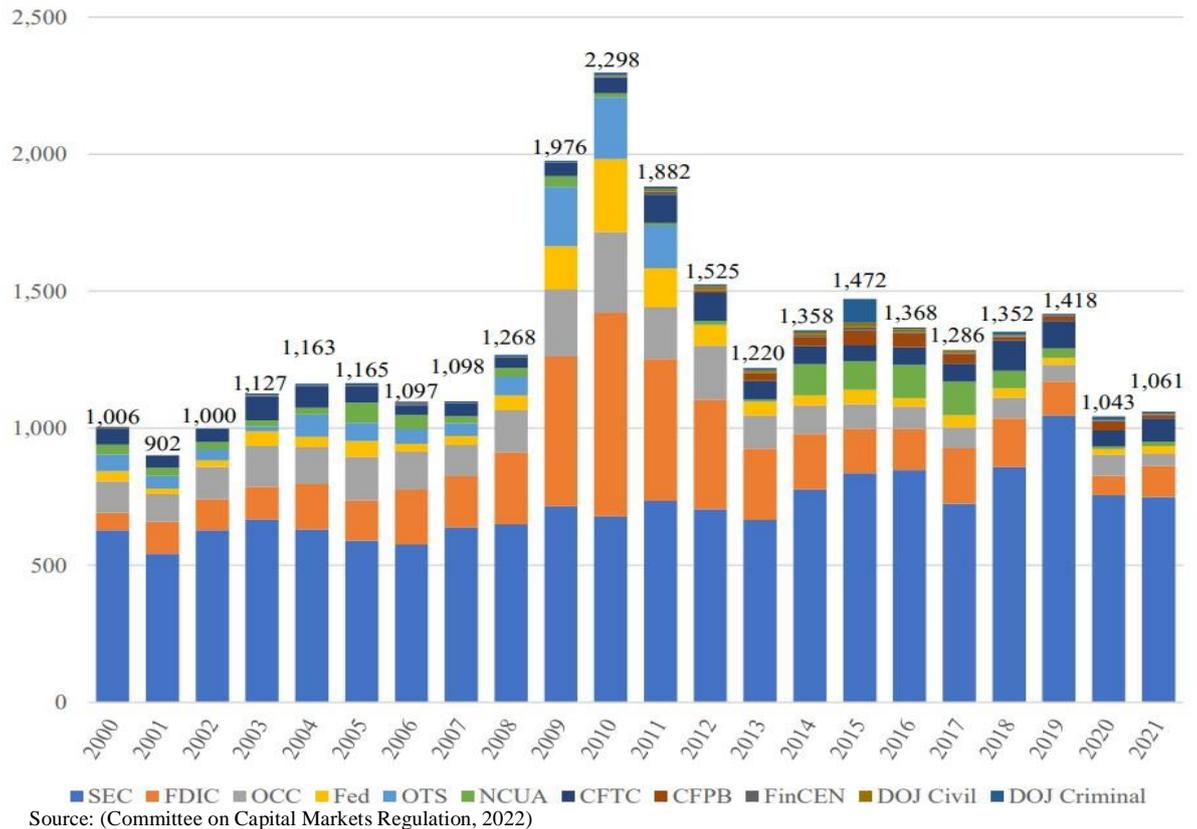
Figure 1.4   Total Number of Enforcement Actions (Size of Lawsuits)

Source: (Committee on Capital Markets Regulation, 2022)
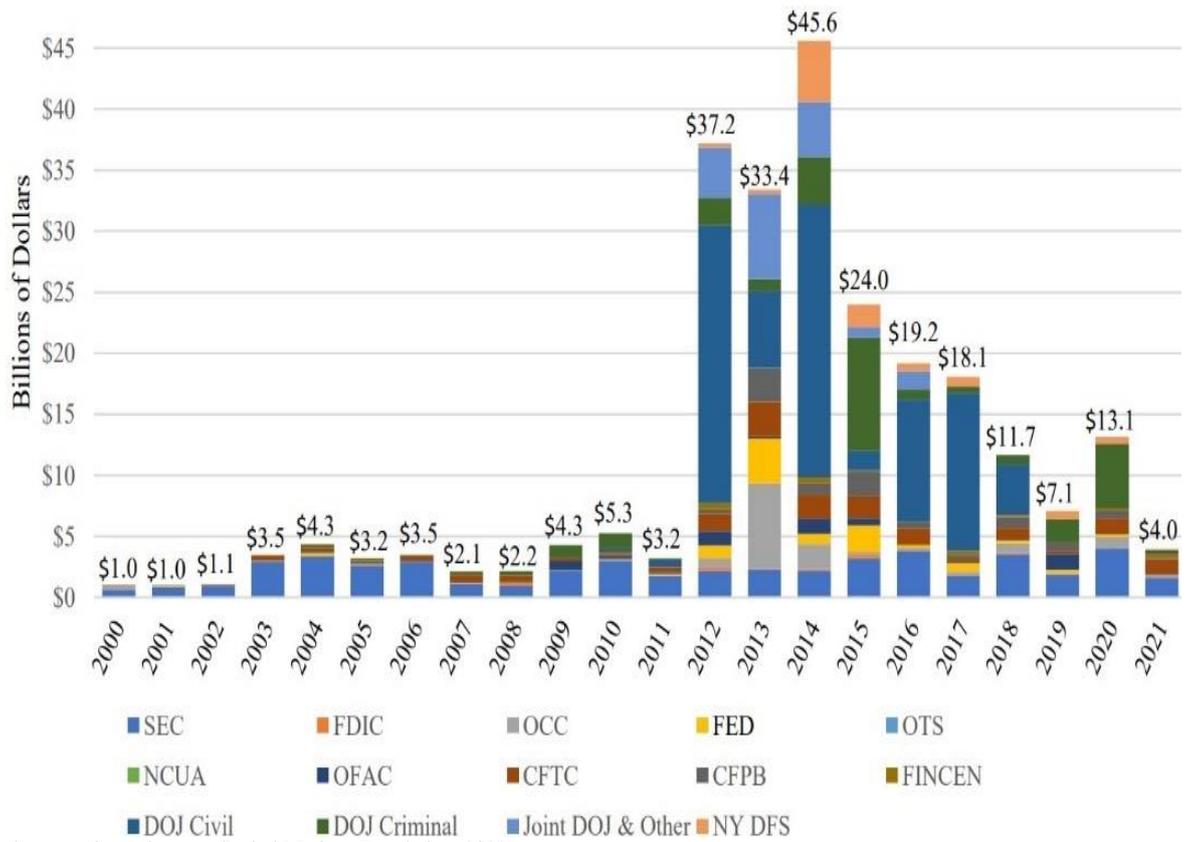
Figure 1.5   Total Monetary Sanctions (Amount of Enforcement Actions)

The legend [4] of the graph identifies the US federal agencies that are mentioned in the report titled "Rationalizing Enforcement in the US Financial System" published by the Committee on Capital Markets Regulation. It is noteworthy that there are more than 40 authorized agencies that carry out enforcement actions against US companies.

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[4] Commodity Futures Trading Commission "CFTC", Federal Deposit Insurance Corporation "FDIC", Consumer Financial Protection Bureau "CFPB", Department of Justice "DOJ", Federal Reserve "Fed", Financial Crimes Enforcement Network "FinCEN", New York Department of Financial Services "NY DFS", National Credit Union Administration "NCUA", Office of the Comptroller of the Currency "OCC", Office of Thrift Supervision "OTS", Office of Foreign Assets Control "OFAC", and Securities and Exchange Commission "SEC".

1.3 Problem Statement

For this study, the corporate moral hazard proxy consists of the amount of enforcement actions and the size of corporate lawsuits. This study examines how the gross amount of enforcement actions, and the size of corporate lawsuits influence ESG performance. Using the US MNCs, this study examines the interaction effect of ownership structure on such a relationship. The study fills several gaps in the literature.

The US strongly supports and encourages its MNCs because they are the mainstay of its economy. It also regulates corporate behavior since corporate moral hazards result in civil and criminal offenses. Moral hazard leads to serious ramifications and may lead companies to file for Chapter 7 or Chapter 11. Corporate moral hazards have attracted the attention of researchers because of their close relations with market reactions, corporate legislation, and the business future of firms. The first scandal paper was published circa 1976 (Sikorski, 2018). Companies need to develop and adopt the moral hazard detection and prevention mechanisms of CG. For that, different CG legislations have been established in different US jurisdictions, e.g., the Dodd-Frank Act of 2010. Moreover, the US has not adopted a CG code for US firms. CG matters are addressed through various legal frameworks at the state and federal levels, as well as in listing rules. A significant development in this regard is the enactment of the Sarbanes-Oxley (SOX) Act in 2002. This legislation imposes numerous CG obligations on publicly traded companies in the US (Zhang Y., 2007). The implementation of the SOX Act was a direct response to widely publicized corporate financial scandals that occurred in the early 2000s. This legislation introduced rigorous regulations for accountants, auditors, and corporate

executives, and imposed stricter recordkeeping obligations. Moral hazard with corporate performance (CP) research includes numerous studies that are conducted outside the CG domain (Utz, 2017; Kuvvet, 2015; Mpiana, 2017; Chapman-Davies et al., 2015; Ehrenhard & Fiorito, 2018; Finnerty et al., 2016). Based on the sturdy relationship between CG mechanisms and the incidence and magnitude of corporate moral hazard, this study considers CG impact using selected mechanisms. This study asserts the fundamental rule of CG for controlling and preventing corporate moral hazards that provides insights for interpreting study results.

The US Congress passed a new US law–the Corporate Transparency Act (CTA)–in 2021. It requires companies to disclose their ownership structures to the US Treasury, as of January 2022. Companies must disclose details about their beneficial owners through a beneficial ownership registry, which is managed by the Financial Crimes Enforcement Network (FinCEN) under the US Treasury Department (Johnson et al., 2022). The CTA provides a definition of a "beneficial owner" as "an individual who directly or indirectly exercises significant control over the entity or owns or controls 25% or more of its ownership interests" (Federal Register, 2022). The ownership structure of a company plays a crucial role in shaping its CG framework. In recent years, there have been noticeable trends in the ownership structure of US firms, driven by changes in CG practices and a growing focus on the impact of ESG factors on decision-making and stock performance (Keller et al., 2022). This results from CG evolution and growing attention to the effect of ESG on corporate decision-making and stock performance. However, it remains uncertain whether leadership and governance within a firm are the primary drivers of its ESG performance, or if firms with strong ESG policies tend to attract specific types of leaders or governance practices. In addition, there are mixed

academic findings regarding the ownership structure effect (Gillan et al., 2021). The current study attempts to study the ownership structure interaction effect on ESG performance and corporate moral hazard relationship. The study adds new insights into the relationship among ESG performance, ownership structure, CG, and corporate moral hazard.

The consequences of the company's collapse on the economy are crucial. The lawsuit has an impact on both the reputation and image of the company and the value of its stocks. Huge, sometimes unexpected, cash payments of penalties also affect the company's liquid assets, especially cash. Thus, the share price and the cash ratio are the most often adopted to examine the cascading reactions of companies' sanctions, as conducted in this study. Besides, the SEC and DOJ statistics indicate that corporate moral hazards in the US are growing in value and volume, quantified in terms of the amount of enforcement actions and size of lawsuits. While FY 2019 was the highest in terms of the size of lawsuits in the US, FY 2020 was the largest based on the value of enforcement actions, according to the previous sections. This increase imposes further investigation into its impact on corporate performance and especially on ESG performance.

However, the same data sources and event study approach have been used to analyze different enforcement action types, such as fraud and scandals. This is in part due to the lack of corporate moral hazard literature (Rowell & Connelly, 2012; Dembe & Boden, 2000). Limited studies were conducted on corporate moral hazard concepts in economics. And the scarcity of moral hazard literature resulted in fragmented research which focuses on specific enforcement types. In fact, all the enforcement action types occur at the same time as a result of weak CG, as shown in

the previous section. Hence, the study investigates the effect of all enforcement action types on CP, i.e., ESG performance, just as they actually occurred in a given year.

Additionally, the literature on corporate moral hazard, such as fraud and scandals, often employs the event study methodology. Event studies analyze the behavior of stock prices of companies during significant corporate events. These studies aim to assess the impact of events like mergers, scandals, or earnings announcements by examining how stock prices respond to these events. The value of event studies lies in their ability to measure the unexpected influence of such events on the wealth of the firm's stakeholders. It is assessed based on the magnitude of abnormal performance (returns) observed. Therefore, event studies focusing on the effects of announcements over a brief period around an event offer valuable insights into understanding corporate policy decisions (Kothari & Warner, 2007). The period of any event study is determined based on the (Event Window). Long-Horizon Event Studies are utilized as well, i.e., longer than 12 months. Sometimes, the post-event window is included to investigate longer-term corporate performance following the event. Previous studies have mostly treated corporate enforcement actions indirectly as an event variable. (Morris et al., 2019) criticize the existing literature because it has mainly concentrated on the announcement-day impacts of SEC actions like AAER[5] postings by Leng et al. (2011), investigation announcements by Feroz et al. (1991) and Karpoff et al. (2009), financial restatements by Anderson and Yohn (2002) and Palmrose et al. (2004), or news of fraud by Karpoff et al. (2012). However, event studies presume that the initial reaction of the market to a key event

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[5] AAERs stands for Accounting and Auditing Enforcement Releases. The SEC issues them when a company commits a violation such as an over-statement of assets and income, intentional falsification of financial statements and inadequate disclosure.

fairly reflects its economic consequences without bias. This premise may be held in certain cases. But if the event has complex unpredictable ramifications, the early market reaction may be incorrect. Using a US sample of horizontal acquisitions, Oler et al. (2008) reveals that the market's early positive reaction to acquisition announcements is refuted by negative post-acquisition long-run-earnings. The conflict implies that the first response was inaccurate and that the error was corrected later. These findings show that an event study of a short window does not precisely reflect the economic outcome of complicated strategic decisions. It is worth mentioning that the event window could be expressed in days; Gande and Lewis (2009), or even years, Bonini and Boraschi (2010). Enforcement action types vary in terms of severity and complexity and the degree of harm caused to firm value and the shareholders' wealth. Additionally, the event study and enforcement action data capture a different reality. Enforcement action data precisely reflect the time, the number, the amount, and the offense type. However, event study uses an offense (event) occurrence time only, regardless of its amount or size or interrelations with other offense types. Consequently, the study examines the impact of corporate moral hazard expressed in amounts and sizes and not as an event to overcome this methodology gap. Also, the study focuses on the typical fiscal year of performance instead of other event windows. Thus, this study follows a generic approach, trying to overcome some limitations of current studies to bring more insights into this area of research. Moreover, the event study has technical flaws just as with other methodologies (Henderson, 1990). McWilliams et al. (1999) demonstrate a critical analysis of CSR Studies based on event study methodology:

"Unfortunately, event studies alone are inadequate because, at best, they provide estimates of the short-run impact on shareholders only and not on other

corporate stakeholders. Furthermore, event study findings are sensitive to even minor changes in research design. The authors illustrate the lack of robustness by examining five recent studies of CSR that report conflicting results. They conclude that these contradictory findings arise from significant differences in research design and implementation". (p. 340)

The event study method ignores different events intercorrelations. According to the Violation Tracker (VT) records, Chevron company, for instance, has an average of 46 violations (lawsuits) per year. If the effect of one type of Chevron enforcement action is examined, it is not possible to isolate or control the impact of other events that occurred within the same event window. Most companies have several enforcement actions throughout the year, which is a normal phenomenon that results from running a business. The event study ignores other enforcement actions that were interlocked into the window of the given event. Conducting an event study for one type of enforcement action would take that event out of context. Isolating one type of offense is possible. But isolating its impact is quite challenging. The study takes control of this flaw by exploring the overall impact of all enforcement actions that occurred in an entire year. Moreover, the performance of the event study is often expressed as a share price which corresponds with the shareholders' perspective. The study uses the ESG score that is relevant to all stakeholders and matches the study underlying base. The share price depends on the assumption of an efficient market. But prices do not immediately or fully reflect all available information.

Evaluating the performance of MNCs is critical, especially in terms of ESG performance. Since the early 1970s, numerous academic studies, exceeding 2000 in number, have been conducted to analyze the connection between ESG factors and

CP. These studies emphasize the significant role played by ESG assessments in shaping business outcomes. Managers often encounter a trade-off between environmental and economic performance due to potential economic drawbacks. However, the expenses associated with improving corporate environmental performance are not considerable. In fact, such enhancements can bring about additional managerial advantages, including boosted morale among employees and increased productivity levels. When Bank of America Merrill Lynch Securities scrutinized 24 ESG-related controversies from the past six years, the result was a loss of $534 billion in market capitalization for large US firms (Fournier & Smith, 2020). Regarding the ESG compliance rate in the US, a recent study confirms 100% of firms in the sample chose to report on their sustainability performance. That is higher than the 96% ratio of the G250, the 250 largest companies globally based on their revenue, and the 80% of the N100, the 100 largest firms in 41 countries (Pareek & Pasumarti, 2021). Additionally, the industry tracker Morningstar (2021) reported that there was a significant jump in the popularity of ESG funds in 2020, resulting in a 29% surge in assets under management[6] (AUM) to almost $1.7 trillion (Jessop & Howcroft, 2021). Likewise, according to Bloomberg (2021), it is projected that ESG's AUM could increase to more than 33% of the estimated $140.5 trillion globally by 2025. In other words, ESG assets are expected to reach $53 trillion. The US witnessed the most significant growth in 2020 and is anticipated to dominate the ESG category starting from 2022 (Diab & Adams, 2021). The special report "ESG under strain" states that the US ESG regulation lags (Thomson Reuters Institute, 2022). It believes that in numerous US states, firms confront more hurdles with ESG. Forty-four new laws in 17 states seek to punish Wall Street firms for taking stances

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[6] AUM refers to the overall worth of investments that an individual or organization oversees on behalf of their clients.

on ESG issues. More intense challenges include climate disclosure regarding emissions, court challenges with several powerful industry groups, and politicization of ESG issues. As a result, evaluating US companies' ESG performance contributes to this troublesome field of research.

Further, corporate moral hazard consequences are significant, sometimes fatal. The US is not an exception, rather it is the best area to study the impact of its firms' offenses given its outstanding regulatory system. Particularly, concerning the growing trend of corporate crimes, as stated earlier. Since 2019 onwards, the number of US corporate violations has exacerbated. Between 6/3/2020 and 24/10/2022, there were 224 fraudulent COVID-19 Products (FDA, 2022).

Only a few corporate enforcement action types are the subject of the present research, e.g., (Kim et al., 2022). Several types, e.g., fraud and scandal, are well studied but are hardly directly measured. To our knowledge, this is the first study that tackles the total enforcement action types, in value and volume, effect on ESG performance. That is the main literature gap that the study is attempting to empirically fill. Finally, in line with the findings of Abhayawansa and Tyagi (2021) and Dimson et al. (2020), the study checks the consistency and convergent validity of ESG providers from the perspective of corporate moral hazard via the robustness check.

In brief, the literature reveals various gaps that indicate the need to investigate how corporate moral hazard influences the ESG performance of US MNCs. The study combines remarkable areas of research to address the interaction impact of ownership structure on ESG performance in the context of moral hazard. This highlights their tangled links and provides extensive empirical insights.

According to genuine considerations, corporate moral hazard and ESG performance are ongoing issues that deserve updating.

1.4   Research Objectives

The study sets out specific research objectives that include:

1- To investigate how enforcement action amount influences the ESG performance of US MNCs.

2- To investigate how lawsuit size influences the ESG performance of US MNCs.

3- To investigate the interaction effect of institutional ownership on the relationship between corporate moral hazard and the US MNCs' ESG performance.

4- To investigate the interaction effect of insider ownership on the relationship between corporate moral hazard and the US MNCs' ESG performance.

5- To investigate the interaction effect of family ownership on the relationship between corporate moral hazard and the US MNCs' ESG performance.

1.5   Research Questions

The research questions put forth are:

1- Does enforcement action amount influence the US MNCs' ESG performance?

2- Does lawsuit size influence the US MNCs' ESG performance?

3- Does institutional ownership interact with the relationship between corporate moral hazard and the US MNCs' ESG performance?

4- Does insider ownership interact with the relationship between corporate moral hazard and the US MNCs' ESG performance?

5- Does family ownership interact with the relationship between corporate moral hazard and the US MNCs' ESG performance?

1.6   Scope of the Study

Whilst the corporate performance related to the CG has been well documented, although controversial, the impact of the moral hazard is poorly understood. This study aims to examine the effect of corporate moral hazard on ESG performance within CG's domain. Additionally, it explores the interaction effect of ownership structure on ESG performance within a corporate moral hazard context. The study is limited to 385 public US MNCs in the period ranging from 2018 to 2022.

1.7   Significance of the Study

This study provides insights to understand how the value of enforcement actions and the volume of lawsuits impact the ESG performance of the US MNCs. There is an expansion of the current understanding of the total value and volume of corporate enforcement actions on ESG performance through CG impact potency. Moreover, the global crisis is a critical issue faced by corporations, policymakers, and CG mechanisms, and Covid-19 is not an exception. The study sample includes FY 2019 and its impact on ESG is investigated.

The study constitutes a strong incentive to initiate building a consistent body of literature on corporate moral hazards. There is a severe lack of corporate moral

hazard literature that integrally captures the main kinds of corporate crimes. Wherefore, researchers borrow insurance terms and elements to fill this shortfall, or they resort to the statutory definitions.

This study contributes to the existing literature pertaining to the relationship between corporate moral hazard and ESG performance. The ESG framework follows a comprehensive approach. This is considered the source of strength of the ESG approach and the fundamental difference from the conventional financial analysis. The total value and volume of corporate enforcement actions are more consistent with the ESG approach than using a single enforcement action type. They are both calculated on an annual basis.

Owners, managers, and executives are accountable for a sizeable portion of corporate crimes, as demonstrated in earlier sections. Therefore, examining how ownership structure interacts with the relationship between corporate moral hazard and ESG performance is another contribution of this research.

Aside from the theoretical usefulness, the study benefits investors and society in general. Because it spreads awareness of recognizing the importance of accessing corporate crime data. Through this research, the community is promoted to create pressure groups demanding more corporate transparency regarding such important data.

On the moral side, specific groups of policymakers are required to act. First, legislative and institutional bodies must legislate to publish sanctioned companies' data to make them publicly available to potential stakeholders. Russia, for example, protects penalized companies by hiding their data. Worse still, Russia banned the banks from downgrading sanctioned companies. Therefore, investors and