EMPLOYMENT DISCRIMINATION LAWSUIT AND CORPORATE STOCK PRICES*

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ABSTRACT

In this study, we examine the financial impact of employment discrimination lawsuit verdicts and settlements on publicly-traded firms subject to lawsuits between 1997 and 2008. Using data on 174 sex and race discrimination lawsuits involving 107 publicly-traded companies, we assess the effect of lawsuit verdicts and settlements on changes in defendants’ daily stock returns. Findings indicate that verdicts and settlements have an immediate negative impact on defendants’ stock prices. In addition, the negative effect is more pronounced among cases that involve monetary payouts, cases in which the U.S. Equal Employment Opportunity Commission is a plaintiff, and cases that involve sex as opposed to race or national origin discrimination. These results demonstrate the extent to which legal rulings introduce a market penalty for employers, and have implications for the study of law, organizations, and market responses to discriminatory behavior.
In 2010, when the Ninth Circuit Court of Appeals ruled that the multi-billion dollar sex discrimination lawsuit against Walmart could proceed to trial as a class action, many news outlets reported on Walmart’s financial woes along with its legal trouble. At the time, Walmart’s total U.S. sales were down for the first time since the company went public, the company reported its third consecutive quarter of losses at new stores, and stocks dropped by a percent on the day of the Court’s decision (Elias 2010). A year later, the U.S. Supreme Court reversed this decision, ruling that the one million female plaintiffs nationwide could not proceed together with their pay and promotion claims. This Supreme Court ruling was a major legal victory for Walmart – and financial as well: Walmart shares were up 18 cents following the decision and had risen as much as 1.3 percent on the day of the verdict (Vicini 2011). Evidently, the market took notice of Walmart’s alternative legal fates in these rulings. And Walmart was not alone; in recent years, Mitsubishi, Cracker-Barrel, Texaco, and other corporate giants experienced similar financial fluctuations as each faced race and sex bias rulings.

Though anecdotal here, the notion that markets reward and penalize firms’ business practices is not new to the economic or sociological literatures. Much research demonstrates the extent to which markets immediately respond to corporate practices, including those involving financial, environmental, and labor concerns (Bartley and Child 2011; Doh, Howton, Howton, and Siegel 2010; Epstein and Schnietz 2002; Flammer 2013; Gangloff, Connelly, and Shook 2014; King and Soule 2007; Rock 2003). These studies argue that investors see accusations of unethical practices as potential threats to firms’ market value and reputation, and subsequently withdraw investment. Building on these insights, we examine if and under what conditions employment discrimination
verdicts and settlements affect the market performance of defendant corporations. Engaging economic and organizational theories of law and markets, we assess the impact of 174 lawsuit verdicts and settlements filed under Title VII of the Civil Rights Act of 1964 and resolved between 1997 and 2008 on publicly-traded defendants’ stock prices. While recent research has examined how social movement activity affects companies’ stock performance (Bartley and Child 2011; Epstein and Schnietz 2002; King and Soule 2007), studies investigating the effect of court decisions, particularly with respect to employment discrimination, are rare. Among the handful of studies that do (Hersch 1991; Selmi 2003; Wright, Ferris, Hiller, and Kroll 1995), results have been mixed. Some scholars find that both the announcement of a lawsuit filing or ruling leads to an immediate drop in stock prices for defendants (Hersch 1991; Wright, Ferris, Hiller, and Kroll 1995), while others find that neither filings nor rulings affect companies’ stock price (Selmi 2003). These studies also primarily focus on class action lawsuits in earlier years (prior to the 1990s) or are based on a small set of cases, rather than a broad swath of individual and class cases.

We advance this body of research by examining the impact of both individual and class-action cases in the contemporary era (1997 to 2008) and assessing how the specific conditions surrounding verdicts and settlements affect their impact on corporate stock prices. We draw on discrimination lawsuit data drawn from Bloomberg’s Bureau of National Affairs (BNA) Employment Discrimination Verdicts and Settlements database matched to stock trading data from the Center for Research in Security Price (CRSP) database. We first use the event study method to examine whether these verdicts and settlements lead to an immediate drop in stock prices for the defendant company, relative
to the company’s past performance, and then provide a regression analysis to examine how the conditions surrounding lawsuit resolutions affect the magnitude of stock price changes.

LAW, ORGANIZATIONS, AND MARKETS

Financial Uncertainty, Moral Legitimacy, and Shareholder Value

Research in law, economics, and organizational sociology provide several reasons to suspect that discrimination litigation has an effect on investor confidence and the market value of firms. One mechanism through which litigation may affect investors’ reaction is largely financial. As Gary Becker (1971) famously argued, discrimination is costly and economically inefficient. Although Becker focused mainly on labor market dynamics, arguing that firms that fail to hire or promote workers on the basis of their sex or race will lose out to non-discriminating firms in recruiting talented workers, discriminating firms may also suffer financially through investment processes. To the extent that discrimination rulings send signals to investors regarding firms’ financial viability and the future costs of doing business (i.e., including legal sanctions and future liability), investors may lose confidence in firms’ practices and adjust their portfolios accordingly. Similarly, Fama’s (1970) “efficient market hypothesis” assumes that stock price reflects all publicly available information, including lawsuits, since investors have access to all relevant information and can react to it quickly. Court decisions may indicate to investors that managerial problems abound in firms’ personnel relations and raise concerns regarding firms’ future cash flows, especially if lawsuits result in extensive monetary damages, organizational restructuring, or consumer boycotts (e.g.
James and Wooten 2006). In short, discrimination verdicts and settlements can affect firms’ stock prices value by creating financial uncertainty in the eyes of shareholders.

Organizational scholars note that the rise of shareholder activism in recent years has rendered investors increasingly attentive to broad employment processes, including personnel practices (Davis and Thompson 1994). In light of this, investors should be especially cognizant of and responsive to information regarding employment practices, such as those implicated in employment discrimination cases, which call into question firms’ personnel arrangements, economic efficiency, and future profitability.

A second mechanism by which employment discrimination verdicts and settlements may affect investors’ response is through moral and reputational imperatives. When investors receive word of employment verdicts and settlements, they may worry not only about the direct material and operational costs but also about the reputational and social damage incurred by rulings and settlements. As institutional scholars have long argued, in order to remain competitive in their respective fields, firms must appear morally, culturally, and legally legitimate to external stakeholders (DiMaggio and Powell 1983; Dobbin 1994; Edelman 1990; Edelman 1992; Fligstein 1996). To the extent that discrimination cases raise suspicions – if not clear evidence – of moral wrongdoing, litigation calls into question firms’ commitment to the well-established ideals of fair employment and equal treatment. Litigation can also generate negative publicity, ignite widespread discontent among employees, and mobilize social movement activity (James and Wooten 2006; Karake 1998; Wooten and James 2004), all of which degrade firms’ reputations, even in the absence of immediate changes in profitability.
Such moral and reputational decline is all the more damaging in the current era of corporate social responsibility. As both scholars and business practitioners recognize, corporate social, moral, and environmental responsibility has become an obligation for businesses and can affect organizational reputation (Karake-Shalhoub 1999; Mackey, Mackey, and Barney 2007). To the extent that discrimination lawsuits can call into question firms’ concern for social and moral responsibility and degrade the corporate image, litigation can depress stock prices by threatening corporate legitimacy among the investment community.

In sum, corporations increasingly operate in a climate where investors actively monitor firms’ practices and social responsibility is high on the corporate agenda. Discrimination verdicts and settlements can lead to sagging stock prices by creating financial uncertainty and threatening the moral legitimacy of corporations.

Evidence from Prior Research on Discrimination Lawsuits

Consistent with our logic, studies in the social movement literature find evidence that companies engaging in unethical labor or environment practices tend to experience significant drops in stock prices immediately following movement activity and consumer boycotts (Bartley and Child 2011; Epstein and Schnietz 2002; Flammer 2013; King and Soule 2007; Rock 2003). However, empirical evidence on whether discrimination litigation generates the same market response has been mixed. For instance, in a study of 260 lawsuits resolved between 1964 and 1986, Hersch (1991) found that the drop in firm value following lawsuits ranged from .29% on the announcement day of all settlements to 15.6% over a 61-day period centered on the day of announcement for firms involved in class action lawsuits. Similarly, in a study of 35 discrimination settlements against
publicly traded companies from 1986 to 1992, Wright and colleagues (1995) found a negative effect of discrimination settlement announcements on stock prices. On the other hand, in a study of 33 class action lawsuits filed between 1991 and 2001, Selmi (2003:1260) found no significant impact of lawsuit filings or settlements on changes in firms’ market returns. Why, then, are the negative effects of lawsuits on stock prices inconsistent, despite the many theoretical reasons for expecting market effects?

One factor that may dampen the market response to discrimination lawsuits is related to the historical context in which lawsuits take place. Scholars note that while civil rights issues were high on political agenda in the 1970s and early 1980s, sustained pressure for fair employment and antidiscrimination enforcement has waned since the 1980s (Kalev and Dobbin 2006; Stainback and Tomaskovic-Devey 2012; Tomaskovic-Devey, Zimmer, Stainback, Robinson, Taylor, and McTague 2006). Kalev and Dobin (2006), for instance, find that legal pressures for organizational equality, including discrimination lawsuits and compliance reviews, were more effective in increasing the share of white women, black men, and black women in management during the 1970s and the 1980s than the 1990s. Similarly, Tomaskovic-Devey and colleagues (2006) show that occupational desegregation on the basis of sex and race occurred more sharply prior to 1980s but slowed and stalled afterward. To the extent that civil rights concerns did not command the same political and public presence in the post-1980s period as they had in previous decades, investors, like other stakeholders, may have paid less attention to discrimination litigation, leading to less pronounced market effects in the 1990s and beyond. Consistent with this logic, Selmi’s study, which is based on lawsuits filed in more recent years (between 1991 and 2001) show no significant impact of lawsuit filings
or settlements on stock prices, while studies based on lawsuits filed during the 1980s or earlier years show significant stock price drops for defendants (e.g., Hersch 1991; Wright et al. 1995).

On the other hand, the passage of the Civil Rights Act of 1991 enabled plaintiffs to recover punitive damages in discrimination cases for the first time. The prospect of punitive damages increases the potential financial burden of litigation, which should heighten the uncertainty associated with litigation as well as shareholders’ attention to it. Because past studies were primarily based on lawsuits prior to 1990s, it is unclear how suits filed in the post-1991 era, where punitive damages are possible, might affect shareholders’ confidence in firms. In addition to the rise of shareholder activism and attention to corporate social responsibility, this increased financial penalty may enhance the market effects of litigation in recent years.

Since the inconsistent findings from prior research may be confounded by these different historical contexts, we seek to identify the empirical impact of employment discrimination litigation on firms’ market value in the contemporary era (1997 to 2008). Furthermore, we extend previous research by specifying the conditions or characteristics of lawsuit resolutions that may contribute to varied effects of litigation on firms’ stock performance, as we discuss below.

**Conditions of Lawsuit Resolutions**

The market costs of legal noncompliance should vary as a function of the perceived financial and moral burden of lawsuit rulings and settlements. Some lawsuits may involve more egregious allegations, result in larger monetary payouts, generate more publicity, and arouse more concern among investors, as compared to others. Below we
discuss several characteristics of lawsuits and their resolutions that should affect the extent to which investors perceive litigation as a threat to financial certainty and corporate legitimacy.

Financial penalties. Although lawsuits on average should negatively affect investor confidence, resolutions that result in larger monetary payouts should be especially likely to attract attention and make investors wary of firms’ financial security, as compared to lawsuits resulting in little or no monetary damages. Indeed, research suggests that investors are most attuned to instances of concentrated financial losses (Eesley and Lenox 2006). The lawsuits in our sample range from settlements involving no monetary damages to the $172 million payout Texaco suffered in the notorious 1997 race discrimination case, Roberts v. Texaco. We expect cases involving costly financial settlements to have a larger negative impact on stock prices as compared to settlements providing little or no monetary relief to plaintiffs.

Legitimacy and reputation. In addition to financial scope, we identify three characteristics of lawsuit verdicts and settlements that call into question the moral legitimacy and reputation of firms. First, while in some cases the plaintiff is an individual worker or group of workers in other cases the U.S. Equal Employment Opportunity Commission (EEOC) represents the interests of the aggrieved workers. Under Title VII, all workers who feel they have been subject to unlawful employment discrimination and wish to take legal action must file a formal claim with the federal EEOC (or an affiliated local agency) before proceeding to court. While the vast majority of these claims are resolved administratively by the EEOC, in some situations the EEOC will pursue litigation on behalf of the complainant, especially if the prima facie evidence
of the case is strong and the case involves issues on its national enforcement agenda (Hirsh 2008). To the extent that the EEOC leverages the legitimacy and regulatory force of the federal government, and provides external validation of employees’ claims, investors may be especially wary of EEOC cases. Thus, we expect lawsuit verdicts and settlements in which the EEOC serves as plaintiff to have a stronger negative impact on stock prices as compared to suits litigated by private parties.

Second, based on prior research (e.g., Hersch’s 1991; Wright et al. 1995), we expect lawsuits that involve a class or group of workers to have a greater impact on investor confidence as compared to individual lawsuits. Because class-based lawsuits allege that the defendant’s employment practices are systematically discriminatory, such cases should provide a stronger signal to investors of moral wrongdoing and illegitimate employment practices. For individual lawsuits, in contrast, investors may assume the plaintiff’s claim resulted from an isolated incident or “personal conflict” rather than systematic bias. Indeed, research has demonstrated that companies are more likely to lose employment discrimination cases when up against a class or group of workers rather than an individual worker (Burstein 1989; Hirsh 2008).

Third, we expect the impact of lawsuit resolutions on stock prices to be more profound among cases that are covered by national media. Media coverage brings widespread attention to the settlement or ruling and magnifies the potential for reputational damage, particularly if coverage is negative and exaggerates the scope of the litigation (Nielson and Biem 2004). To the extent that investors are concerned about firms’ reputational standing, the enhanced visibility of firms’ unlawful behavior should heighten investors’ negative reactions. While no previous research examines the impact
of media coverage of employment discrimination litigation on stock prices, studies of social protests and boycotts report a significant relationship between media coverage of the target event, market value, and organizational change (King and Soule 2007:432; King 2007). Based on this research, we expect stock market declines to be especially pronounced in cases where lawsuits resolutions are covered by national media.

**Other case characteristics.** The market impact of discrimination lawsuits may also vary as a function of the details of the case itself and how the case is disposed in court. Under Title VII of the CRA of 1964 and related EEO legislation, workers can bring claims citing discrimination on the basis of sex, race, color, national origin, religion, age, and disability status. In this study, we focus exclusively on cases involving sex, race, and national origin discrimination, which are linked to a corporate diversity, an important aspect of corporate social responsibility. Because previous studies of employment discrimination claims suggest that plaintiffs fare better in sex discrimination cases as compared to race and national origin cases, both in court and through the EEOC’s administrative process (Hirsh 2008; Nielsen, Nelson, Lancaster, and Pedriana 2008), we examine whether the market response varies for sex and race/national origin cases.

Though we lack data on the specific nature of disputes raised in each claim, we are able to distinguish among cases that involve harassment, retaliation, and personnel-related issues (i.e., hiring, promotion, termination, pay).¹ We examine whether the

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¹ Workers can allege retaliation if they suspect their employers retaliated against them for complaining (either internally or externally) about discrimination targeting themselves or another worker. Harassment claims involve unwelcome conduct that is sufficiently enduring or severe to render the workplace a hostile environment. Personnel-related cases typically involve claims of differential treatment on the basis of sex, race, or national origin in employers’ decisions regarding hiring, promotion, termination, pay, assigning work hours or tasks, etc.
different legal causes of action and evidentiary standards involved in these alternative types of cases affects investors’ reactions.

Finally, the cases we examine can be disposed by verdict (including jury, bench or directed) or by settlement. Because verdicts provide opportunities for legal rule-making and precedent-setting, they may be more publicly visible than settlements. In addition, previous research has found that discrimination lawsuits often lead to more favorable outcomes for plaintiffs in cases that produce verdicts as compared to those that settle (see Albiston 1999; Nielsen and Nelson 2005; Priest 1980; Priest and Klein 1984). Due to the increased visibility and attention that verdicts receive, investors may be more responsive to verdicts as compared to settlements. Thus our analyses distinguish between cases that result in verdicts and those that settle.

DATA

We collected information on discrimination lawsuits from Bloomberg’s Bureau of National Affairs (BNA) Employment Discrimination Verdicts and Settlements database. The BNA database contains information on major employment discrimination verdicts and settlements that resulted in large settlements or cases that were precedent setting in some way. The database covers verdicts and settlements from 1997 to present and includes information on the names of parties, the dates of verdicts or settlements, the amount of any monetary awards, the basis of discrimination (i.e., sex, race, national origin), and the statute(s) cited in each lawsuit. From this database, we identified 193 Title VII sex, race, or national origin discrimination lawsuits filed against firms publicly traded on the NYSE, AMEX, or NASDAQ stock exchanges from 1997 to early 2008. Next, we obtained data on companies’ daily stock prices before and after the lawsuit
resolution date from the Center for Research in Security Price (CRSP) database and matched this stock return information to our lawsuit dataset. The resulting dataset includes 174 lawsuit verdicts and settlements that occurred from 1997 to 2008 involving 107 publicly-traded companies.\(^2\)

Our analysis focuses on lawsuit resolutions, namely court verdicts and settlements, rather than lawsuit filings. While filings entail allegations of discrimination against a firm, court verdicts and settlements provide legal interpretations of corporate behavior that are binding and potentially precedent-setting, and thus may carry more influence and authority than filings. Moreover, focusing on verdicts and settlements allows us to examine how the scope of lawsuit resolutions affects the impact of litigation on market processes. Finally, from a modeling standpoint, court rulings provide a cleaner analysis of the market impact of litigation because corporate and legal actors are less likely to know the outcome of a case prior to a ruling or settlement whereas court filings are prone to information leakage prior to the actual filing date (i.e., executives, investors, and other stakeholders may anticipate lawsuits filings).

In addition to data on lawsuit resolutions and stock prices, we also collected data on “confounding events,” which may independently affect stock prices. Using daily editions of *The New York Times*, we identified major corporate events, including corporate restructuring, price changes, new products, dividends or earnings announcements, joint ventures, acquisitions, other litigation, executive changes, changes in forecasted earnings, layoffs, debt-related events, and new contracts (McWilliams and

\(^2\) Though 174 major lawsuit resolutions filed against publicly-traded companies represent a fraction of the 10,000 to 15,000 Title VII discrimination lawsuits filed each year (see Nielsen et al. 2008), studying the market’s reaction to these high-profile lawsuits is important, given that publicly traded firms are highly visible and prestigious corporations, and often set practices or norms for the business community.
Siegel 1997), that were reported 5 days before or 5 days after the lawsuit verdict or settlement date (see methods section for a discussion of this window). In a subset of our analyses, we use only cases that do not have any confounding events occurring during the event window, in order to ensure that confounding events are not responsible for any observed changes in stock prices. Restricting the sample to lawsuit verdicts and settlements without confounding events produces 136 lawsuits. We also used daily editions of The New York Times to identify the extent of media coverage surrounding each lawsuit resolution. The New York Times coverage is considered to be a reliable source of national media coverage surrounding corporate events (see Earl, Martin, McCarthy, and Soule 2004).³

METHODS

Our analysis involves two stages. In the first stage, we use the event study method to assess whether firms’ stock prices following the announcement of lawsuit resolutions are significantly different than the expected stock prices based on the company’s previous market performance. In the second stage of analysis, we use regression analysis to estimate the effects of characteristics of lawsuit resolutions on variation in stock prices, and thus identify the conditions under which lawsuit resolutions most profoundly impact stock returns.

Estimating Abnormal Returns: Event Study Method

To investigate whether lawsuit resolutions negatively affect defendant firms’ stock prices, we employ an event study technique, which is a statistical method frequently used in the financial literature to assess the impact of a target event on firms’

³ For a subset of cases, we coded media coverage in The Wall Street Journal. Consistent with the observation from other studies (e.g., King and Soule 2007), we found that the case coverage in The New York Times is more comprehensive than that of The Wall Street Journal.
stock prices (Brown and Warner 1985; Fama, Jensen, Fisher, and Roll 1969; MacKinlay 1997; McWilliams and Siegel 1997). The event study method has been used to evaluate the effect of lawsuits, social movement activity, and corporate social responsibility efforts on stock prices (e.g., Hersch 1991; King and Soule 2007; Koku, Qureshi, and Akhigbe 2001; Selmi 2003; Sergius Koku 2006; Ursel and Armstrong-Stassen 2006).

An event study determines whether a company’s actual stock price immediately following an “event” (e.g., a lawsuit) is abnormally different from the “expected” stock prices during a pre-determined period surrounding the event (or “event window,” e.g., -5 to + 5 days from the event). The abnormal stock price returns are determined by the cumulative abnormal return (CAR), a standard measure used in event studies (for a review of the methodology, see Brown and Warner 1985; Fama, Jensen, Fisher, and Roll 1969; MacKinlay 1997).

CAR is calculated through several steps. First, we estimate expected returns (R).

$$R_{jt} = \alpha_j + \beta_j R_{mt} + \epsilon_{jt}$$

Where $R_{jt}$ is daily rate of return for firm $j$ over period $t$, and $R_{mt}$ is the market return. We use Standard and Poor’s 500 Composite Index as the measure of the market return. $\beta_j$ is the systematic risk for firm $j$, $\alpha_j$ is the baseline return for firm $j$ when $R_{mt}$ is zero, and $\epsilon_{jt}$ is a disturbance term of firm $j$ over period $t$. The disturbance term is assumed to be normally distributed with mean zero and constant variance. Substantively, expected returns ($R_{jt}$) represent firm $j$’s expected stock returns on day $t$, adjusting for the fluctuation of the market returns on that day. The regression coefficients for this model are based on a 239-day trading period prior to the beginning of the event window.
Next, based on expected returns \((R_{jt})\) and actual returns, we calculate *abnormal returns* \((AR)\):

\[
AR_{jt} = R_{jt} - \alpha_j - \beta_j R_{mt}, \quad \text{where } t = -5, -4, \ldots, +4, +5
\]  

\(AR\) represents the differences between the actual returns and the expected returns, for each firm for each day during the event window. Thus, a negative value of \(AR\) means that the actual daily return on the day \(t\) are lower than expected while a positive \(AR\) means that the actual return on the day \(t\) is greater than the expected values.

Finally, after calculating \(AR\), we sum all of the daily \(AR\)s for the event window for each defendant firm to calculate the *cumulative abnormal return*, \(CAR\):

\[
CAR_j = \frac{1}{T} \sum_{t=1}^{T} AR_{jt}, \quad t = -5, -4, \ldots, +4, +5
\]

where \(T\) is the number of trading days during the event window period.

In our analysis, we primarily use an 11-day event window (five days prior to and five days following the ruling or settlement date), which we think optimal to capture the full scope of investors’ reactions while avoiding violation of the efficient market assumption (i.e., that investors have immediate access to information and quickly respond to it) – a basis of the event study method. However, we also supplement the results using other lengths, including a 3-day (-1 to +1), 7-day (-1 to +5), and 16-day (-5 to +10) window. We extend the event window up to 5 days before the verdict or settlement date, considering that the verdict or settlement date information is public, and investors may adjust their portfolio in advance (Fama, Jensen, Fisher, and Roll 1969; McWilliams and
Siegel 1997). However, unlike some studies that allow more days prior to the event (e.g., -26 days), we focus on short event windows prior to the event since the outcomes of court decisions and settlements have little chances of information leakage. We also focus on short event windows following the event rather than longer windows (e.g., 30 days or more) because using a long event windows increases the chance of “false negative” results (i.e., the lawsuit effect is present but the significance of the effect is not detected by the test statistics) and also makes it difficult to tease out the lawsuit effect from that of confounding events (see Brown and Warner 1980, 1985; Mcwilliams and Siegel 1997).

After calculating CAR, we determine the statistical significance of the averaged value of CAR during the event window using a t-test (using robust standard errors), following MacKinlay (1997). In addition, we report the proportion of positive CAR across the sample and conducted a generalized sign test ($GS$, also known as binomial Z statistics; see McWilliams and Siegel 1997) to test whether the proportion of positive returns among targeted firms is significantly different from the expected proportion, which would be 0.5 if completely random.

$$GS = \frac{|p_0 - p|}{\sqrt{p(1-p)/N}}$$, where $p = 0.5$ \hspace{1cm} (4)

Regression Analysis

In the second part of our analysis, we use OLS regression to identify the effect of lawsuit verdict and settlement conditions on changes in CAR. This enables us to identify how characteristics of lawsuits and resolutions affect the extent to which companies’ stock returns measured during the event window deviate from the expected return.
Because our data include multiple lawsuits filed against the same firm, we calculate robust standard errors to take into account this clustering by firm.

*Dependent variable.* The dependent variable in all regression analyses is the cumulative abnormal return (CAR) based on an 11-day event window (-5 to +5) among cases that do not have confounding events during the event window (N=136). Table 1 shows the means of CAR across all firms for cases both with and without confounding events. Across our full sample, the mean of CAR is -0.8 percent, which suggests that, on average, a verdict or settlement leads to a drop in stock price for the defendant company by 0.8 percent. When excluding cases with confounding events, the mean of CAR is -1.37 percent, indicating that the average drop in stock prices is larger for this subset. The statistical significance of CAR will be tested and discussed in the results section below.

[Table 1 about here]

*Independent variables.* To identify characteristics of lawsuit resolutions that may account for variation in CAR, we employ the following independent variables. First, we include a measure of the monetary penalty associated with verdicts and settlements, expressed in 100,000 U.S. dollars. The average monetary award is 6.2 million dollars. About a quarter of the cases in our sample generated monetary penalties of over a million dollars, with the largest being a 172 million-dollar payout. On the other hand, 20 percent of our sample did not generate any monetary awards, which presumably indicates that the verdict or terms of settlement were not favorable for the plaintiffs. Indeed, upon inspection of these decisions, we found that 24 cases (14 percent of our sample) were resolved with outcomes *unfavorable* to the plaintiffs. Nearly all of these were appellate court decisions which reversed lower courts’ rulings in favor of plaintiffs. Because our
measure of monetary penalties is also capturing the extent to which resolutions are favorable or unfavorable to the plaintiff, we do not include a separate indicator for direction of the verdict/settlement.\textsuperscript{4}

Second, since lawsuits brought by the EEOC may be seen as more legitimate by investors, we include a dummy variable, coded 1, to identify cases where the EEOC is a plaintiff on the case. About 40 percent of our sample cases include EEOC as a plaintiff.

Third, following previous research (Hersch 1991; Selmi 2003; Sergius Koku 2006), we expect class action lawsuits to have a larger impact on stock prices as compared to individual claims. The BNA database includes both class action and individual lawsuits, but does not distinguish between them. Thus, we include a dummy variable coded 1 to identify cases that involve two or more plaintiffs; single-plaintiff cases are coded 0. About 22 percent of our sample involves cases with multiple plaintiffs. Though ideally we would have data on cases that were certified as class action, we were not able to find definitive information on class certification for many cases.\textsuperscript{5} Thus, we use the indicator of multiple plaintiffs to identify suits that entail some degree of collective action on the part of workers, but may or may not be class-certified. Nielsen et al. (2008:38) show that cases that involve two or more plaintiffs result in more favorable outcomes for plaintiffs in court as compared to single-plaintiff cases.

\textsuperscript{4} In supplementary analysis, we tried including a dummy variable coded 1 for resolutions that were favorable to the plaintiff and 0 for those unfavorable for the plaintiff. Not surprisingly, this dummy variable was negative and significant, indicating that defendants experienced a larger stock price drop when case outcomes were favorable to the plaintiff. However, because this measure was collinear with our indicator of monetary penalties, we did not include it in our final models. We also estimated models excluding cases that were not favorable to plaintiffs; results were nearly identical to our analysis in which we restrict cases to those that produce monetary awards (see model 2 in table 2 below).

\textsuperscript{5} Among the 38 lawsuits in our sample that involve two or more plaintiffs, we identified 3 as certified class action, 17 as not certified class actions, but could not find definitive information regarding class action status for the remaining multiple-plaintiff suits.
Fourth, to measure media coverage, we employ a dummy variable, coded 1, to identify lawsuits covered by *The New York Times* during the event window period. Only 9 percent of cases received such media attention.

We also include measures to account for the basis of discrimination, how the case was disposed, and time. To assess whether suits alleging sex, race, and/or national origin differ in their impact on stock prices, we include a series of dummy variables that identify charges citing discrimination on the basis of sex only and both sex and race/national origin; cases citing only race or national origin discrimination are the referent. We use a dummy variable coded 1 to identify cases that cite harassment as a basis of discrimination; cases that do not involve harassment are the referent. We also include a dummy variable coded 1 to identify cases that involve retaliation; cases that do not list retaliation as a basis of discrimination are the referent. To distinguish between verdicts and settlements, we use a dummy variable to identify lawsuits that are disposed by verdict (including jury, directed, and bench); settlements are the referent. Finally, to adjust for annual variation in stock prices, we include a series of dummy variables that identify the calendar year in which the lawsuit was resolved.

**RESULTS**

**Lawsuit Resolutions and Abnormal Returns**

As predicted, results from our event study analysis (table 2) indicate that settlements and verdicts negatively affect companies’ daily stock returns. The mean of CAR, expressed as a percentage and using the 11-day event window, is -0.81. This indicates that on average, stock prices are 0.81 percent lower than expected in our sample of companies during the 11-days (-5 to +5) surrounding the lawsuit verdict or settlement.
When cases with potentially confounding events are excluded from the sample, the negative effect of litigation is greater; stock prices are -1.37 percent lower than expected over the same 11-day window.

We also examined the proportion of positive CAR and conducted a generalized sign test to examine whether the proportion of positive to negative returns among targeted firms exceeds the expected proportion (i.e., 0.5). The proportion of positive CAR and generalized sign test statistics provide strong evidence that verdicts and settlements significantly lower the daily returns of defendants (see the last two columns of table 2). The mean proportion of positive CAR for the 11-day window is 0.42 for the full sample, indicating that stock prices fell in 58 percent of our cases. The results are even more pronounced when excluding cases with confounding events. The proportion of positive CAR is 0.37 ($p < .01$), which indicates that 63 percent of verdicts and settlements result in negative stock returns for defendants.

For some cases, lawsuit verdicts and settlements produced especially pronounced effects. Among cases without confounding events, about 20 percent, or 27 cases show drops of over 5 percent during the event window. For instance, Walmart’s stock price dropped by 8.4 percent following a ruling by the Tenth Circuit Court in 1999, Morgan Stanley’s stock fell 7.7 percent after settling a sex bias suit in 2007, and Coca Cola’s dropped 5.7 percent after their race discrimination suit was settled in 2005. These individual cases are all significant at the 0.05 level in the event-specific test.6

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6 Event specific test statistics = $\frac{CAR}{\sqrt{\frac{S(AR)^2}{T}}}$, where $CAR$ is Cumulative Abnormal Return (see also the Method section), $S(AR)$ is a standard deviation of Abnormal Return, and $T$ is the number of days in the event window.
Table 2 also presents changes in CAR using several different event windows, with consistent results across the varying event windows. Applying shorter event windows also show that verdicts and settlements significantly lower defendant companies’ stock prices, by -0.74 percent for a 3-day event window (-1 to +1) and -0.78 percent for a 7-day event window (-1 to +5), compared to their expected values. Using a longer event window produces more dramatic drops in stock returns; with a 16-day window (-5 to +10 days), stock prices drop by -1.76 percent. This result suggests that the negative impact of verdicts and settlements on stock prices extends as long as 10 days beyond the ruling or settlement date, though results using this longer event window are more likely to be influenced by potentially confounding events. The generalized sign test statistics in table 2 also provide consistent evidence of negative stock returns in response to lawsuit resolutions across event windows of varying lengths. The mean proportion of positive values is significantly smaller than 0.5 in all results, with the exception of the 7-day event window, for which the GS test statistic \( t=1.52 \) does not reach significance at conventional levels.

**Regression Analysis**

Having demonstrated that employment discrimination verdicts and settlements negatively affect firms’ stock prices, we next investigate how the characteristics of cases and their outcomes affect variation in defendants’ cumulative abnormal returns (CAR). The three models presented in Table 3 are based on an 11-day event window (-5 days to +5 days) and include only cases without confounding events (regardless of whether or not they were found to have abnormal returns in the event study analysis). We first estimate the impact of lawsuit conditions on CAR among all of these cases (see model 1). Next,
to examine whether cases that more profoundly threaten corporate financial certainty and moral legitimacy lead to greater drops in stock price, we estimate models separately for cases that involve monetary payouts (model 2) and cases in which the EEOC serves as a plaintiff (model 3).\(^7\) In all models, we use CAR multiplied by 100 as the dependent variable so that all coefficients refer to the effect on the percent changes in stock prices. All variables are centered at their mean values to facilitate a meaningful interpretation of the model intercept.

[Table 3 about here]

Model 1 estimates the impact of various lawsuit characteristics that may affect the impact of lawsuit verdicts and settlements on firms’ market value. The intercept term is significantly negative, which suggests that the mean CAR is negative even after adjusting for factors included in the model. Specifically, daily stock returns are -1.4 percent lower, holding all other variables at their means.

Although we expected the financial scope of lawsuit resolutions to negatively affect CAR, our results indicate that an increase in the dollar amount of monetary awards is negatively associated with CAR but is not statistically significant at the.05 level.\(^8\) We also expected the heightened legitimacy and reputational threat of EEOC cases to dampen stock prices; again, though we find a negative effect of EEOC representation on CAR, this effect is not significant at convention levels. Nor do cases that involve two or more plaintiffs and media coverage show significant effects.

\(^7\) In addition to EEOC cases, we also hypothesized that cases that involve collective action (class action and multiple plaintiff cases) as well as those covered in the national media will especially threaten corporate legitimacy and reputation. However, we are not able to estimate separate models for these cases due to their small numbers (less than 10 percent of cases were covered by The New York Times).

\(^8\) In additional analyses, we also explored potential nonlinear effects of monetary penalties using a log transformation and a categorical variable (awards less than $100,000; between $100,000 and $500,000; and more than $500,000). These measures were not statistically significant.
Consistent with findings from prior research that show more favorable outcomes for sex suits compared to race suits both at court and in terms of their subsequent impact on workplace equity (Hirsh 2008; Kalev and Dobbin 2006; Nielsen et al. 2008; Skaggs 2008, 2009), our results show that sex cases lead to larger losses in stock value among defendants. The CAR of cases involving sex discrimination only is -3.7 percent lower as compared to cases involving race or national origin discrimination. This result suggests that the negative effect of verdicts and settlements on stock prices is driven largely by sex discrimination cases; in fact, our supplementary analysis (not shown) shows that race or national origin cases actually have a small positive impact on stock values. These varied effects may be due to differences in the resource and legal capacity of sex versus race plaintiffs (see Nielsen et al. 2008; Burstein 1989), as women who bring sex cases are more typically from the professional ranks, and may appear more threatening to investors.

We also investigated the effect of lawsuits that involve harassment or retaliation disputes. Cases that involve claims of harassment have significantly positive returns to CAR by 3.6 percent, suggesting that negative stock returns are driven largely by disputes that involve personnel-related issues rather than harassment. One possible interpretation of this result is that investors are more concerned with lawsuits that involve hiring or promotion processes, which are indicative of problems with firms’ ability to recruit and retain talented workers, as compared to harassment, which more typically implicate interpersonal dynamics.

In model 2, we explore the hypothesis that cases larger in financial scope generate more profound market effects. Because lawsuits that result in monetary payouts are more
likely to draw the attention of investors and create uncertainty regarding firms’ financial
outlooks, and also are indicative of court decisions that are favorable to plaintiffs, model
2 restricts analysis to cases that result in monetary penalties; this specification eliminates
23 cases where plaintiffs did not receive any monetary payout.9 While the results are
similar to those in model 1, the magnitudes of the effects are larger. The intercept has a
larger negative value, -2, which suggests that lawsuits resolved with monetary awards
lower the stock price of defendant firms by 2 percent, net of the lawsuit characteristics
and conditions considered in the model. When compared to the intercept in model 1, the
magnitude of the intercept in model 2 is 30 percent larger, suggesting that lawsuits that
create a financial burden for firms elicit a more negative reaction from shareholders.
This finding underscores the importance of modeling the impact of lawsuit outcomes –
rather than simply filings – on stock prices. The effect sizes for other variables are
slightly larger but consistent with those shown in model 1.

Finally, in model 3, we investigate whether cases filed by the EEOC lead to larger
drops in defendants’ stock prices owing to their greater threat to corporate legitimacy.
Thus, we restrict analysis to the 61 cases that are filed by the EEOC, rather than private
plaintiffs. The intercept indicates that verdict or settlement announcements among EEOC
cases lower defendants’ stock returns by -4.9 percent. This is over three times larger than
the 1.4 percent drop observed for all cases (model 1). Compared to cases with monetary
payouts, the nearly 5 percent drop in stock prices among EEOC cases is more than double
the 2 percent drop for cases with monetary awards (model 2).

9 In additional analyses, we also tried restricting models to cases that resulted in monetary penalties in
excess of $500,000 and to cases that had outcomes favorable to plaintiffs; results were similar to those
presented here.
The results in model 3 also show that EEOC suits disposed by verdicts have -8.4 percent lower CARs as compared to lawsuits disposed by settlement. Arguably due to the visibility and precedent-setting capacity of verdicts, our findings suggest that, among EEOC cases, those disposed by verdict have a greater market impact on defendant companies, as compared to settlements. Unlike previous models, however, among EEOC cases, sex discrimination cases do not differ in their effect on CAR as compared race/national origin cases nor do cases citing harassment have different effects. One interpretation of these findings is that having the resources and legitimacy of the EEOC as plaintiff may minimize the impact of other case characteristics, though it is also possible that the standard errors are larger due to the reduced sample size and statistical power of these coefficients.

In sum, we find strong evidence that employment discrimination verdicts and settlements have an immediate negative impact on companies’ stock prices. Among cases without confounding events, we find that 63 percent experience a drop in stock prices during the 11-days surrounding the announcement of the verdict or settlement. Our regression analysis shows that the negative effect of litigation on stock prices is more pronounced among cases that involve monetary payouts, cases that involve sex as opposed to race or national origin discrimination, and among cases in which the federal EEOC lends legitimacy by signing on as plaintiff.

**Robustness Analysis**

In this section, we consider alternative explanations for our findings and report the results from robustness checks. First, we consider the possibility that investors may react differently to firms that were subject to multiple verdicts or settlements as compared
to those with only a single lawsuit. If companies were involved with multiple lawsuits during our study period, would this elicit a more negative market reaction? If so, would our results be largely driven by the particularly large stock price drops of companies with multiple lawsuits? To investigate this possibility, we first compare the magnitudes of CAR between our full sample and the subset of the sample that only includes companies subject to multiple verdicts or settlements (49 percent of our sample) over the study period, 1997 to 2008. We found that companies with multiple lawsuits experienced a larger drop in stock prices (-1.68%) during the 11-day event window compared to the full sample (-1.37%), among cases without confounding events. When we estimated separate regression models for cases where the defendant was involved in multiple suits and for cases where defendants were involved in only a single lawsuit over the study period, we found that the constants, which represents the average effects of verdicts and settlements with all predictors at their means, were negative and marginally significant (p<.10) in both models. We also re-ran the regression models across the full sample including a dummy variable to identify firms with multiple suits; this measure was not significant in any models. Based on these analyses, we conclude that firms involved in multiple suits experience a slightly larger drop in stock prices compared to those experiencing only a single suit, but firms with a single suit also experience the market penalty.

Next, given our small sample size and variability in the scope of lawsuit verdicts and settlements, we closely examined whether our regression results are driven by particularly influential cases. To explore this possibility, we re-calculated our test statistics omitting 7 cases that we found to be potentially influential using Cook’s D. The mean CAR decreased from -1.37% to -1.26% for the 11-day window among the cases
without confounding events, but remained substantial and significant \( (t = -2.52) \). We also fit our regression models in table 3 after excluding 8 potentially influential cases identified by Cook’s D based on model 1. Again, the average effect sizes (as given by the constant) decreased but remained substantial and statistically significant across all models.

CONCLUSIONS

The goal of this study was to identify the market impact of sex, race, and national origin employment discrimination litigation on corporations subject to court verdicts and settlements in recent years. We find that publicly-traded firms subject to Title VII sex, race, and national origin discrimination lawsuits suffer a loss in stock market value immediately following the announcement of a legal settlement or verdict. We also find that both the financial reach of verdicts and settlements and their perceived threat to corporate legitimacy affect the market impact of litigation. These findings have several important implications for the study of law, markets, and organizations.

First, the negative effect of litigation on defendants’ stock prices indicates that the financial damage of discrimination litigation extends well beyond the immediate costs of the suit. In line with Fama’s (1970) “efficient market hypothesis,” litigation introduces new information regarding the legality of business practices, the moral legitimacy of firms’ behavior, and the potential future costs associated with bringing employment practices into compliance with the law. Such information raises uncertainty about defendants’ financial outlook and reputational standing for investors, and subsequently, depresses firms’ market value. As both theories of shareholder activism and corporate social responsibility would predict, litigation shapes the market environments of
corporations. Organizations are held accountable for their business practices not only by the courts but also by investors, who are cognizant of and responsive to corporate activity in the broader socio-legal environment.

In contrast to previous research that has documented weakened effects of EEO law on corporate behavior in recent years (Kalev and Dobbin 2006; Selmi 2003; Stainback and Tomaskovic-Devey 2012), as compared to the 1970s and early 1980s, our results suggest that market audiences are attentive to high-profile employment discrimination verdicts and settlements in the contemporary era. These findings, as well as those from the social movement literature (Bartley and Child 2011; Epstein and Schnietz 2002; King and Soule 2007; Rock 2003), indicate that shareholders are increasingly responsive to issues that were once mainly the purview of political and moral fields. Thus while political pressure for equal employment has waned in recent decades, markets pressures may have taken up some of the slack. In addition, since our data include lawsuits settled in the post-1991 era of punitive damages, the threat and fact of punitive awards may have created stronger market effects, as compared to lawsuits settled prior to 1991, without the possibility of such costly payouts.

Although modest, we do find that the average drop in stock prices for defendants is more pronounced among suits that result in monetary damages. Given the financial penalty, investors likely see such suits as indicative of financial costs moving forward – in terms of paying fines, making personnel and operational changes, and guarding against future discrimination and liability. In the face of such financial uncertainty, shareholders respond by removing capital.
Cases for which the EEOC serves as plaintiff appear to produce especially pronounced drops in stock prices. To the extent that the EEOC lends legitimacy to plaintiffs’ claims of discrimination, this finding suggests that having the institutional backing of a federal enforcement agency makes investors more wary of court rulings and settlements. Although previous research has called into question the enforcement capacity of the EEOC (Dobbin and Sutton 1998; Pedriana and Stryker 2004), our results suggest that the EEOC retains influence in the eyes of external corporate stakeholders.

Though we also hypothesized that lawsuit verdicts and settlements that involve multiple plaintiffs and those covered by the national press would further depress stock prices given their increased potential for reputational damage, our results do not bear this out. This may reflect the relatively small numbers of cases that involve multiple plaintiffs (38 cases) and media coverage (16 cases). Or the effect of these variables may be overshadowed by more defining case characteristics, such as monetary awards, since the vast majority of cases that involve multiple plaintiffs and media coverage result in monetary payouts.

Consistent with previous research showing that sex discrimination suits experience more favorable outcomes in court (Nielsen et al. 2008) and that defendant corporations are more likely to expand opportunities for (white) women as compared to racial minorities following litigation (Kalev and Dobbin 2006; Skaggs 2008, 2009), we similarly find that investors are more responsive to sex discrimination verdicts and settlements as compared to race or national origin ones. This differential market impact of sex versus race/national origin lawsuit resolutions may reflect disparities in social class, resource capacity, and legal representation among sex and race plaintiffs, as
plaintiffs in sex cases tend to be of more privileged class backgrounds, have better resources, and experience more favorable outcomes at court (see Nielsen et al. 2008; Burstein 1989). As a result, investors may be more responsive to sex cases. The fact that this sex-race differential evaporates when examining just EEOC cases (table 3, model 3) suggests that the legitimacy and resource capacity of the EEOC may put race/national origin cases on equal footing with sex cases in terms of their market impact.

Overall, the fact that we find more pronounced market effects for some types of lawsuit verdicts and settlements as compared to others underscores the need to investigate the nuances and conditional impact of the law on market audiences and potentially other corporate stakeholders. The weight of the law is clearly felt more heavily in some instances than others. Our results, for instance, suggest that the law’s influence on markets depends on its financial scope, perceived legitimacy, and resource capacity. The uneven impact of litigation on stock prices observed in previous research may be the result of these varied conditions under which lawsuits occur. Thus scholars interested in the link between law, markets, and organizations should continue to explore the conditional effects of legal pressure to identify the factors that give the law more or less influence in market and corporate environments. Such factors may also help explain why some employers respond to employment discrimination litigation by improving sex and race equity, while others, in the words of Wooten and James (2004), “fail to learn” from their legal transgressions.

Finally, to the extent that litigation dampens investors’ confidence in firms, as we have shown here, executives and managers may make a concerted effort to expand opportunities for women and racial minorities in an effort to avoid future lawsuits and
financial fallout. Prior studies show that while firms’ general reputation (e.g. Fortune reputation rankings) and sales are quite resistant to ethical concerns, shareholders are responsive (e.g., Bartley and Curtis 2011). This suggests that the combination of litigation and falling stock prices may effectively draw corporate executives’ attention to personnel problems that they might have ignored otherwise. Thus, one of the most important implications of the finding that discrimination litigation negatively affects stock prices may be the pressure that falling stock prices create for corporate decision makers to adopt more equitable employment practices and promote corporate diversity.
REFERENCES


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<tr>
<th>Variable</th>
<th>All cases</th>
<th>With no confounding events</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mean</td>
<td>Std. Dev.</td>
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<td>Cumulative abnormal return (percent)</td>
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<td>Amount of award ($100,000)</td>
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<td>EEOC plaintiff</td>
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<tr>
<td>N</td>
<td>174</td>
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Table 2. Mean CAR and proportional of negative CAR for employment discrimination lawsuit event windows, 1996-2008

<table>
<thead>
<tr>
<th>Event window</th>
<th>Mean CAR (percent)</th>
<th>T</th>
<th>Proportion of positive CAR ($p_0$)</th>
<th>Generalized sign test (GS)</th>
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<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All lawsuits (N=174)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11-day window (days -5 to +5)</td>
<td>-0.81$^+$</td>
<td>-1.77</td>
<td>0.42$^+$</td>
<td>2.12</td>
</tr>
<tr>
<td>3-day window (days -1 to +1)</td>
<td>-0.74$^{**}$</td>
<td>-2.70</td>
<td>0.43$^*$</td>
<td>1.97</td>
</tr>
<tr>
<td>7-day window (days -1 to +5)</td>
<td>-0.78$^+$</td>
<td>-2.01</td>
<td>0.44</td>
<td>1.52</td>
</tr>
<tr>
<td>16-day window (days -5 to +10)</td>
<td>-1.76$^{**}$</td>
<td>-2.79</td>
<td>0.37$^{**}$</td>
<td>3.34</td>
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<td>Lawsuits with no confounding events in event window (N=136)</td>
<td></td>
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<td></td>
<td></td>
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<tr>
<td>11-day window (days -5 to +5)</td>
<td>-1.37$^*$</td>
<td>-2.61</td>
<td>0.37$^{**}$</td>
<td>3.09</td>
</tr>
</tbody>
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$^+$ $p<.10$, $^*$ $p<.05$, $^{**}$ $p<.01$ (two-tailed)
Table 3. OLS regression predicting cumulative abnormal return (CAR, expressed as percentage) of targeted firms of employment discrimination lawsuits, 1996-2008

<table>
<thead>
<tr>
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<th>Model 1</th>
<th>Model 2 w/Monetary Awards</th>
<th>Model 3 w/ EEOC plaintiffs</th>
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<tbody>
<tr>
<td>Constant</td>
<td>-1.364*</td>
<td>-1.996**</td>
<td>-4.903*</td>
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<td>(0.531)</td>
<td>(0.603)</td>
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<td>(0.004)</td>
<td>(0.011)</td>
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<td>-2.131</td>
<td>--</td>
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<td></td>
<td>(1.775)</td>
<td>(1.976)</td>
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<td>(1.606)</td>
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<td>(1.939)</td>
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<td>-3.732*</td>
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<td>(1.559)</td>
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<td>(2.658)</td>
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<td>(1.444)</td>
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Note: Robust standard errors, obtained by clustering firm observations, are presented in parentheses. Variables are centered at their means. 
+ p<.10, * p<.05, ** p<.01 (two-tailed)