

What shapes CSR performance? Evidence from the changing enforceability of non-compete agreements in the United States

Abstract:

This paper investigates whether companies strategically engage in corporate social responsibility (CSR) practices to retain employees. Under a unique setting of exogenous variations in non-compete law enforceability in the U.S., we examine the relation between the changing enforceability of non-compete agreements and firms' CSR performance. Using a difference-in-differences design, we find that an increase in the enforcement of non-compete agreements (which enhances a firm's ability to retain employees) deteriorates CSR performance. In cross-sectional tests, we find that peer pressure affects CSR performance interactively with the enforceability of non-compete agreements; specifically, the strategic role of CSR performance in employee retention is more pronounced for firms facing higher peer pressure (i.e., firms that are R&D intensive and in highly competitive industries). We further find a negative relation between the absolute enforceability of non-compete agreements and CSR performance. The above findings are consistent with the notion that firms strategically engage in CSR practices to retain employees, thereby reducing the knowledge spillover associated with employee mobility.

JEL Codes: G30, J6, K2, L25, L50, M5

Keywords: Non-compete Agreements, Enforceability, CSR Performance

“Employees don't stay with a company because of benefits. It is the long-term relationship-building that attracts people to stay.”

- Jeff Swartz, CEO of Timberland¹

1. Introduction

This paper investigates whether companies strategically engage in corporate social responsibility (CSR) practices to retain skilled employees. Public awareness of how businesses impact environmental and social conditions is growing. Outside capital suppliers use both financial and CSR-related information to make investment decisions. Empirical evidence suggests that sustainable investing has grown faster than traditional investment in the U.S. In the 2008 financial crisis, sustainable and responsible investing (SRI) assets outperformed professionally managed assets as a whole (Social Investment Forum Foundation, 2010).²

In addition to the intention to attract investments from outside capital suppliers, firms may engage strategically in CSR activities with the aim to retain their own employees. On the one hand, according to the neo-classical economics framework, firms require only monetary reward contracts to align employees' interests with those of the firm. In that sense, investment in CSR is not related to employee retention. The existing literature on labor economics, finance, and management focuses, in large part, on using monetary incentives to retain employees (Hölmstrom, 1979). On the other hand, firms may use both monetary and nonmonetary incentives to align employees' individual interests with organizational interests. However, empirical evidence suggests that

¹ Jeff Swartz responded to a question about whether his company's commitment to corporate social responsibility is reflected in a lower turnover rate at GreenBiz's State of Green Business forum in Washington D.C. in Feb 2011 in front of a crowd of senior CSR and sustainability executives (<https://www.forbes.com/sites/csr/2011/02/25/can-csr-retain-employees/#612f62e25aa6>).

² Socially responsible investments commonly avoid companies that produce or sell addictive substances (like alcohol, gambling, and tobacco) and seek out companies engaged in social justice, environmental sustainability and alternative energy/clean technology efforts. SRIs can be made in individual companies or through a socially conscious mutual fund or exchange-traded fund (ETF).

monetary incentives underlying the sensitivity of pay to performance have some limitations; for instance, monetary incentives may be an imperfect indicator of individual effort, may induce employees to game the system, and can be easily imitated by competitors. In this study, we argue that as a nonmonetary incentive, CSR can be used as an effective employee governance tool that helps retain employees. For example, prior literature documents that employees are willing to accept lower wages and pay cuts to stay in socially responsible firms (Burbano, 2016; Frank and Smith, 2016; Bode et al., 2015) or are more inclined to stay in such firms when faced with extreme negative scenarios, such as the 9/11 attack (Carnahan et al., 2017). Further, when faced with favorable situations (e.g., increased unemployment insurance or a rejection of inevitable disclosure doctrine), firms tend to increase their engagement in CSR practices in order to improve their image and to attract employees (Flammer and Luo, 2017; Flammer and Kacperczyk, 2019). Overall, this empirical evidence suggests that CSR performance plays a strategic role in retaining employees and reducing the risk of knowledge spillover associated with employee mobility.

To provide large-sample, systematic evidence on the role of CSR performance in human resource management (HRM), this study examines whether corporate managers strategically use CSR to retain and attract employees and, if so, how effective this employee retaining mechanism is. In so doing, we take advantage of a unique setting characterized by changes in employee mobility across rivals and thus by the risk of knowledge spillover among them. Specifically, we utilize the initiation of non-compete agreements in the U.S. as an exogenous shock to the employee retention mechanism. Our analysis focuses on the enforceability of non-compete agreements.³ Employee know-how is a key source of sustainable competitive advantage (Barney, 1991; Hall,

³ As will be further explained in Section 2, non-compete agreements (also known as covenants that do not compete) are contracts that restrict workers from voluntarily or involuntarily joining (or forming) a new rival company after they depart from an existing company.

1993), yet high-skilled employees also render high risk of job mobility to the firm (Coff, 1997; Carnahan et al., 2012; Kacperczyk, 2012). Non-compete agreements are argued to be effective in preventing employees from switching to a rival firm (Marx, 2011); however, in reality, signed non-compete agreements are not guaranteed to be enforced by a court. Although non-compete agreements are lawful in most states, their enforceability is determined by the jurisdiction across different states. For example, non-compete agreements in California and North Dakota are almost entirely unenforceable in a court of law, whereas states such as Massachusetts and Tennessee are more likely to require employees to prove the unreasonableness of non-compete agreements (Shaikh, 2015). In a broad sense, a high enforcement level of non-compete agreements has a significantly negative impact on employee mobility across rivals (Marx et al., 2009; Garmaise, 2011).

Garmaise (2011) constructs an index based on 12 questions to measure the enforceability of non-compete agreements for each state in the period of 1992–2004. While the enforceability index of non-compete agreements can be used as a proxy for the degree of labor mobility, it is mostly time invariant and encounters potential endogeneity in explaining firm-level CSR performance. Garmaise (2011) documents four exogenous shocks to the enforceability of non-compete agreements during the period of 1992–2004 in three states: Texas, Florida, and Louisiana. Specifically, the index score of Texas decreases from 5 to 3 in 1994, that of Florida increases from 7 to 9 in 1996, and that of Louisiana first decreases from 4 to 0 in 2001 and then returns to 4 in 2003. These four exogenous changes/shocks to the enforceability of non-compete agreements (that took place in the three states mentioned above) are defined based on these substantial variations (at least 2 score changes) of Garmaise’s index. Recent studies have adopted variations in the enforceability index as an exogenous shock to examine how changes in non-compete agreement

enforceability affect corporate governance and earnings management (Chen and Zhou, 2018; Shaikh, 2015). In these studies' research designs, the value of the indicator variable equals 1 (-1) when enforcement increases (decreases) and zero otherwise.

This changing enforceability of non-compete agreements provides us with a unique setting in which to investigate whether companies strategically engage in CSR practices. It introduces an exogenous variation in knowledge spillovers: the stricter is non-compete agreement enforcement, the less threatening is the knowledge spillover associated with employee mobility. In response to the threat of this knowledge spillover, firms are expected to strategically increase their CSR performance in order to retain employees. High CSR performance can mitigate the risk of knowledge spillovers by reducing employees' concerns and improving the firm's overall image or reputation capital. Accordingly, when the enforceability of non-compete agreements increases, firms are less motivated to engage in CSR activities to retain employees. In contrast, when there is less enforceability of non-compete agreements, firms are likely to devote more effort to CSR activities in order to attract and retain their employees.

Due to the data availability requirement, our sample starts in 1996. As such, our analysis is affected by only three exogenous shocks that took place in two states in three different years, i.e., Florida (1996) and Louisiana (2001 and 2003). Ertimur et al. (2018) document that there are no other substantial variations across states in the enforceability of non-compete agreements in period 2004-2008.⁴ To ensure consistency with the enforceability index from Garmaise (2011), we restrict our sample period to 1996-2008 and focus only on the three shocks that occurred in Florida and Louisiana.

⁴ The substantial variation is defined as at least 2 score change in the enforceability index.

In testing our research question, we use the difference-in-differences (DiD) approach, which allows us to make a causal inference on the effects of the changing enforceability of non-compete agreements on firms' CSR performance. We measure CSR performance using Kinder, Lydenberg, and Domini (KLD) data. Our main finding reveals that an increase in the enforceability of non-compete agreements leads to worse CSR performance. This result supports the hypothesis that stricter non-compete agreements increase the barrier of labor mobility, decrease the concern of employee retention, and thus reduce firms' incentives to engage in CSR activities. In the cross-sectional tests, we further examine the interactive role of peer pressure with the changing enforceability of non-compete agreements in determining a firm's CSR performance. Knowledge spillover risk is more damaging for firms with higher peer pressure (e.g., firms that are R&D intensive and in highly competitive industries). Our results support the prediction that the strategic role of CSR performance is more pronounced for firms with higher peer pressure. Specifically, R&D-intensive firms and firms in competitive industries tend to curtail their CSR engagement to a greater extent when faced with an increase in non-compete agreement enforceability. Finally, we examine the relation between the absolute enforceability of non-compete agreements and firms' CSR performance and find strong evidence in support of the negative association between the two.

Our study adds to the CSR literature by exploiting state-level staggered regulations that impact the enforceability of non-compete agreements as a quasi-natural experiment setting in which to apply the DiD research design. Our setting is novel in that these staggered regulations introduce labor mobility shocks to the skilled labor market through the changing enforceability of non-compete agreements. In addition, our study contributes to the existing literature by examining the interaction effects between non-compete agreement enforceability and peer pressure on CSR performance. Our evidence supports the strategic role of CSR in firms' employee retention by

showing that the changing enforceability of non-compete agreements has a negative impact on firms' CSR practices. Accordingly, our results lend strong support to the strategic role of CSR engagement in employee retention when firms face varying risk of labor mobility and knowledge spillover.

The paper proceeds as follows. Section 2 reviews the related literature and develops the hypotheses. Section 3 describes the data collection and methodology. Section 4 presents the empirical results and robustness tests, and Section 5 concludes.

2. Relevant Literature and Hypotheses

2.1 Institutional background of non-compete agreements

Non-compete agreements (also known as covenants that do not compete, or CNCs) are contracts that restrict workers from voluntarily or involuntarily joining (or forming) a new rival company after they depart from an existing company. CNCs function as safeguards to protect the current employer's proprietary information and reduce potential competition by prohibiting employees from joining a competitor in the same market or a geographical area for a determined period of time.

However, in reality, a signed non-compete agreement it is not guaranteed to be enforced by a court. Although non-compete agreements are lawful in most states, their enforceability is determined by the jurisdiction across different states.⁵ First, a non-compete agreement is designed to protect a legitimate business interest (e.g., trade secrets, proprietary business information,

⁵ American Bar Association summarizes some key points that courts consider in deciding whether to enforce a non-compete agreement: 1. Protectable Interests; 2. Ordinary Competition; 3. Consideration; 4. Reasonableness; 5. Signature; 6. Changed Circumstances; 7. Non-solicitation Restrictions; 8. Fairness; 9. Judicial Modification; and 10. Prohibition. For further details, see: https://www.americanbar.org/groups/gpsolo/publications/gpsolo_ereport/2015/october_2015/is_noncompete_agreement_enforceable

customer goodwill). In practice, if a departed employee's working for a competitor is unlikely to harm the firm's legitimate business interest, then a court is unlikely to enforce the non-compete agreement. Second, employees are required to sign a non-compete agreement *before* employment. If an employee was asked to sign a non-compete agreement *after* his or her employment commenced and without being given compensation (promotion, bonus, or additional benefits), then the validity of the agreement may be highly questionable. Moreover, a court will render a non-compete agreement unenforceable when the circumstances have changed or become unreasonable. Finally, a court does not always invalidate the entire non-compete agreement if it is partially unenforceable; the court may also modify the unenforceable provisions or just highlight them.

A non-compete agreement is the outcome of a bargaining game between an employer and an employee. Specifically, it balances the protection needed by the firm and the harm done to the employee (Blake, 1960). Prior empirical evidence reveals that employee know-how is a key source of a company's ability to achieve and sustain competitive advantage (Barney, 1991; Hall, 1993). However, employees with valuable skills and knowledge are more likely to be attracted to rival firms (Campbell et al., 2012a; 2012b; Carnahan et al., 2012; Coff and Kryscynski, 2011; Ganco et al., 2015). The concern is that employees with valuable knowledge are motivated to join a rival firm or create a new venture when faced with a sufficient increase in future wages (Kacperczyk, 2012; 2013; Starr et al., 2018). Firms have incentives to restrict employees with valuable knowledge from joining a rival firm or creating a new venture of their own. For employees, the restrictions from joining a rival firm reduce their future salary due to the lack of a raise that switching jobs would afford them. Furthermore, the restriction on knowledge spillover suppresses future innovation and economic growth (Blake, 1960).

In recent years, non-compete agreements have been developed and implemented in many U.S. states; however, their enforceability varies significantly across states (Bishara, 2011). For example, non-compete agreements in California and North Dakota are almost entirely unenforceable in their legal courts. In contrast, most other states enforce non-compete agreements according to specific versions of the ‘rule of reason’, which allows some variations in determining the enforceability of non-compete agreements. While the enforceability index of non-compete agreements can be used as a proxy for the degree of labor mobility, it has several limitations. Above all, it is mostly time invariant and encounters potential endogeneity in explaining firm-level CSR performance: Firms’ CSR performance may be endogenously determined by factors other than the enforceability of non-compete agreements. Furthermore, it can be used only at the state level and cannot determine whether a specific firm extensively uses a non-compete agreement in its employment contract. While the status of non-compete agreement enforceability remains static across different states, there are exceptions. For example, in the 1992-2004 period, Texas decreased the enforceability of non-compete agreements in 1994, Florida increased enforcement in 1996, and Louisiana first decreased enforcement in 2001 and then revoked the rule in 2003 (Garmaise, 2011).⁶ These changes provide exogenous variations in the enforceability of non-compete agreements when examining a manager’s behavior in response to restricted labor mobility.

⁶ First, in June 1994, in *Light vs. Centel Cellular Co. of Texas*, the Texas Supreme Court increased the requirements for the enforceability of non-compete agreements. Following the ruling, an employer must offer an employee specific consideration in exchange for a non-compete agreement. The court’s ruling also applied retroactively to all such agreements signed in Texas. This action quasi-exogenously decreased the non-compete enforcement score from 5 to 3. Second, Florida strengthened the rights of employers in non-compete enforcement in 1996 (implementing, among other stipulations, a presumption of injury to a firm when a non-compete agreement is violated) and increased the enforcement score to 9 from an already high score of 7. Finally, in 2001, Louisiana decreased the enforceability of non-compete agreements (where employees were not prohibited from joining a competing firm in which they held no equity interest), and the state’s non-compete enforcement score went down from 4 to 0. However, Louisiana later retracted this ruling and thereby increased its enforcement of non-compete agreements in 2003, bringing the score back to 4.

A growing body of research has exploited this unique setting by using a DiD design to examine whether and how changes in non-compete agreements affect corporate governance and earnings management: For example, Garmaise (2011) finds that increasing non-compete agreement enforceability leads to longer CEO tenure; Chen and Zhou (2018) document that stricter enforcement environment increases managerial attention to short-term earnings benchmarks; and Shaikh (2015) investigates how changes in non-compete laws influence management forecasts of annual earnings. In this paper, we explore whether firms strategically engage in CSR activities when faced with varying enforceability of non-compete agreements.

2.2 Literature review on CSR performance

There are two compelling and competing explanations for why firms engage in CSR: legitimacy theory and stakeholder theory. While legitimacy theory suggests that CSR engagement is part of a process of legitimization, stakeholder theory perceives CSR performance as a strategy to maximize profits and to balance shareholders' financial interests against the interests of other stakeholders. Management takes control of the whole process (including the degree of stakeholder inclusion) by strategically collecting and disseminating only the information it deems appropriate to advance the corporate image, rather than being truly transparent and accountable (Ball et al., 2000). Specifically, the strategic function of CSR engagement works through a two-fold mechanism: decreases in 'walking' (i.e., former employees joining a rival firm) and 'talking' (i.e., former employees disclosing the firm's valuable knowledge when they join a rival firm) (Flammer and Kacperczyk, 2019). With regard to the walking aspect, CSR engagement can retain employees by improving the attractiveness of the work content. Empirical evidence also documents that firms engaging in social initiatives or environmentally friendly efforts are better able to retain employees

(De Roeck and Delobbe, 2012; Bode et al., 2018; Carnahan et al., 2017). As for the talking aspect, CSR engagement might enhance employees' social ties and identification with their former organization, making them less inclined to disclose the proprietary information of their previous employer after joining a rival firm. Therefore, socially responsible firms are better able to foster employees' commitment and retain employees (Albinger and Freeman, 2000; Greening and Turban, 2000; Peterson, 2004; Sheridan, 1992; Turban and Greening, 1997; Vogel, 2005; Wang et al., 2009).

Public awareness of how businesses impact environmental and social conditions is growing. In addition to considering financial performance, investors use CSR-related information to make investment decisions. Empirical evidence suggests that SRI has grown faster than traditional investing in the U.S. In the 2008 financial crisis, SRI assets outperformed professionally managed assets as a whole (Social Investment Forum Foundation, 2010). Recent literature also documents that socially responsible firms tend to enjoy greater institutional ownership and lower cost of capital (Dhaliwal et al., 2011; 2012) and that these firms receive higher analyst coverage, as investors tend to avoid investing in sin stocks such as alcohol, tobacco, and gaming companies (Hong and Kacperczyk, 2009).

In addition to the intention to attract investments, firms strategically engage in CSR activities with the aim to retain their employees. Past literature suggests that firms can improve employees' job motivation and reduce employees' concerns by enhancing employees' perception of their current employment or by improving employees' monitoring of their employers (Coff, 1997). If their current employment is superior to their alternative options, employees are more motivated to engage in their jobs and less likely to engage in adverse behavior at the workplace. These adverse behaviors include reduced interest, effort, or attentiveness (Rusbult et al., 1988);

employee theft or fraud (Dickens et al., 1989; Pierce et al., 2015; Schnatterly, 2003); or disengaged behavior such as using company time to do personal business or search for a better job (Acemoglu and Shimer, 2000; Rusbult et al., 1988). To align an individual employee's interests with those of an organization, firms can use various employee governance mechanisms, including both monetary and nonmonetary incentives.

Broadly speaking, the extant literature in management and economics focuses mostly on the design of monetary incentives. Empirical evidence suggests that tying worker compensation directly to firm outcomes via performance pay can help align the interests of employees with those of the firm (Hölmstrom, 1979). However, compensation schemes that tie pay closely to performance could create several problems. First, monetary incentives can be based only on observable variables such as outputs or profits, which may be imperfect indicators of individual effort – for example, output often derives from workers' collective efforts in a team (Hölmstrom, 1982). Second, these mechanisms create incentives for employees to game the system (Frank and Obloj, 2014; Oyer, 1998), sabotage the work of their co-workers (Lazear, 1989), or engage in corporate misconduct (Harris and Bromiley, 2007). Third, for multiple-task jobs, employees have incentives to overperform on the tasks that are well rewarded and underperform on other tasks (Hölmstrom and Milgrom, 1991). Last but not least, monetary incentives can easily be imitated by competitors and hence may not be effective in sustaining a firm's competitive advantage (Coff, 1997). Thus, in addition to monetary incentives, firms need to strategically utilize other nonmonetary employee governance tools to increase an employee's job motivation and engagement.

CSR engagement can be an attractive alternative as an employee governance tool. In theory, individuals in large firms are concerned about the relevance of their daily work. CSR

activities have an explicit societal impact and can enhance employees' sense of a meaningful existence and sense of belonging (Bauman and Skitka, 2012), increase their self-affirmation (Cable et al., 2013), and make employees perceive that their employer is acting in accordance with fundamental principles of justice and morality (Ellemers and Haslam, 2011). Therefore, corporate social initiatives should also positively influence employee retention. Recent literature has also revealed that CSR practices play a potentially important role in employee retention. For example, Brekke and Nyborg (2004) assert that CSR is a labor market screening strategy that enables firms to attract highly motivated and productive employees who are willing to accept lower wages (Burbano, 2016; Frank and Smith, 2016) or pay cuts (Bode et al., 2015) in order to work for socially responsible firms. When faced with negative scenarios (e.g., the 9/11 terror attacks), employees are inclined to stay with socially responsible firms (Carnahan et al., 2017). When faced with favorable situations with a lower cost of being unemployed (e.g., increased unemployment insurance or rejection of inevitable disclosure doctrine), firms tend to increase their engagement in CSR practices in order to retain employees (Flammer and Luo, 2017; Flammer and Kacperczyk, 2019). All of these empirical studies suggest that CSR performance plays a strategic role in retaining employees and reducing the risk of knowledge spillovers associated with employee mobility.

2.3 Hypothesis development

The changing enforceability of non-compete agreements introduces exogenous variations in the exit barrier: the stricter is non-compete agreement enforcement, the lower is employee turnover. In response to changing non-compete agreements, firms need to increase employee motivation via HRM. HRM plays an important role in CSR and employee commitment to the organization (Jamali

et al., 2015). In particular, HRM plays an effective role in determining CSR by enhancing recruitment, retention, and productivity (Willard, 2002). Specifically, HRM and CSR converge around common goals and outcomes within a co-creation framework (Prahalad and Ramaswamy, 2004; Hatch and Schultz, 2010). The CSR-HRM co-creation model maps the HRM role over three periods of the CSR lifecycle (Waddock et al., 2002): (1) inception and strategy setting; (2) enacting CSR implementation; and (3) engaging in learning or improvement through continuously assessing outcomes and adjusting strategy making and implementation accordingly. In the inception period, HR managers can contribute to defining the CSR vision and identifying relevant stakeholders. In the implementation period, HRM can potentially play a strategic role in raising employees' awareness and readiness to implement CSR. In the learning and improvement period, HR managers provide opportunities for employees to express their views in relation to CSR. They can also contribute to CSR through their capabilities and expertise in HRM functions, including training and development, recruitment and selection, performance appraisal, and compensation (Orlitzky et al., 2006).

In sum, the CSR-HRM co-creation model highlights the strategic role of HRM in bolstering CSR performance by setting the tone and facilitating the implementation of the CSR agenda. Empirical evidence has also shown a positive retention effect associated with corporate social initiatives (Bode et al., 2015). Therefore, when faced with loose non-compete laws, firms can use CSR as an HRM tool to improve the overall firm image and retain employees. Increased enforceability of non-compete agreements imposes exit barriers to retain employees, and therefore, firms are less motivated to engage in CSR activities in order to retain employees. Based on the arguments presented above, we state the first hypothesis as follows:

H1: *The enforceability of non-compete agreements is negatively associated with CSR performance, all else equal.*

In addition to facing pressure from shareholders and other outside stakeholders, managers face peer pressure from competitors in their industry. Peer pressure derives from both internal sources, such as competencies (e.g., valuable and rare resources), and external sources, such as competition for market shares in the industry. Both R&D and CSR are intangible assets, which are very difficult to imitate and substitute. R&D and CSR investments create assets that provide firms with competitive advantage (Branco and Rodrigues, 2006). Thus, we examine the effect of internal peer pressure related to R&D expenditure and external peer pressure related to market shares.

First, empirical studies document that R&D intensity positively affects CSR performance in certain industries (Padgett and Galan, 2010). Therefore, R&D intensity is expected to influence firms' CSR performance interactively with variation in the enforceability of non-compete agreements. R&D-intensive firms are faced with more peer pressure since they are more vulnerable to knowledge spillover risk when certain employees depart. Accordingly, firms with high R&D intensity are expected to decrease (increase) their CSR performance to a larger extent than those with low R&D intensity when the enforcement of non-compete agreements increases (decreases).

Second, we investigate the CSR performance effect that arises from the CSR performance of peer pressure externally induced by market competition. According to the commonly held view, external competitiveness is defined by market shares (the Herfindahl-Hirschman Index). Anecdotal evidence suggests that there is a positive relation between CSR and financial performance (Griffin and Mahon, 1997; McWilliams and Siegel, 2001). Researchers have proposed an alternative explanation that CSR generates a competitive advantage for firms through

stakeholder value creation (Freeman, 1984). Therefore, external competitiveness is expected to influence a firm's CSR performance interactively with the enforceability variations of non-compete agreements. Firms in competitive industries are faced with higher labor mobility, more knowledge spillover, and stronger peer pressure. Accordingly, they are expected to decrease (increase) their CSR performance to a larger extent when faced with stricter (weaker) non-compete agreement enforceability. In sum, we predict the interaction effect between peer pressure and non-compete enforceability changes on CSR performance as follows:

H₂: *The negative effect of stricter non-compete enforceability on CSR performance is more pronounced for firms facing higher peer pressure, all else equal.*

3. Research Design

3.1. Empirical specification

Garmaise (2011) developed a ranking of each state's enforceability of non-compete agreements from 1992-2004. He uses 12 questions to evaluate the enforcement level of non-compete agreements in each state, granting each state 1 point when its laws are above specific thresholds (see Appendix for further details). He classifies the level of enforcement in each state on a scale from 0 for no enforcement (California, North Dakota) to 9 for extremely strong enforcement (Florida). Ertimur et al. (2018) extend the time period (of 1992–2004) covered by Garmaise's measure to 1980-2013. We use the extended measure from Ertimur et al. (2018), which is consistent with the Garmaise (2011) measure on the overlapping years. While the enforcement score can range in principle from 0 to 12 (as 1 or 0 point is assigned to 12 questions in each state), the Garmaise (2011) enforcement index ranges from 0 to 9, as Garmaise considers any states with a score of 9 to have the strongest enforcement.

Instead of directly using the degree of non-compete agreement enforceability in each state, we use the only substantial variation in the enforcement score for each state to construct the enforceability index for each state. In other words, we consider the only substantial change in the enforcement score (with absolute changes greater than or equal to 2) to be a substantial change. This substantial change is likely to be exogenous in that it is *not* controllable by individual firms. In this sense, its use helps us alleviate concerns about potential endogeneity. Although the state-level enforceability index cannot determine whether a specific firm extensively uses non-compete agreements in its employment contract, it can still provide a solid and unique setting in which to investigate the overall CSR strategy of a firm within each state as a response to varying labor mobility.

To examine the relation between an increase in the enforceability of non-compete agreements and firms' CSR engagement, we follow the previous literature (Chen et al., 2018; Shaikh, 2015; Aobdia, 2018); specifically, we use a DiD design based on the exogenous variations in Garmaise's rank of non-compete agreement enforceability. The regression is as follows:⁷

$$CSR_{it} = \beta_0 + \beta_1 INEF_{it} + \beta_{j,it} X_{j,it} + \beta_r + \beta_i + \beta_s + \varepsilon_{it} \quad (1)$$

where CSR_{it} represents CSR performance, and $INEF$ is a categorical variable that ranges from -1 for a change to weak enforcement to +1 for a change to strong enforcement, with the value of 0 assigned to no change in the enforcement strength. The overall positive CSR performance score is

⁷ The empirical specification of model (1) can be written in a DiD research design:

$CSR_{it} = \beta_0 + \alpha_1 Treatment_{it} \times Post_{it} + \alpha_2 Treatment_{it} + \alpha_3 Post_{it} + \beta_{j,it} X_{j,it} + \beta_r + \beta_i + \varepsilon_{it}$, where *Treatment* indicates states (Texas, Florida, and Louisiana) that experienced non-compete enforceability changes during 1992-2013, and *Post* represents the year that the enforceability changes took place. $INEF$ in model (1) represents $INEF \times Post$. The incorporation of state and year fixed effects in Model (1) effectively achieves a difference-in-differences research design with a continuous treatment.

defined as the KLD strength score (CSR_str), which is calculated by summing all aspects of CSR strengths; the overall negative CSR performance score is defined as the KLD concern score (CSR_con) by summing all aspects of CSR concerns. Overall CSR performance (CSR_net) is measured by subtracting CSR_con from CSR_str . The coefficient of interest is β_1 , which measures the effect of an increase in non-compete enforceability on firms' CSR. Hypothesis 1 predicts that β_1 should be negative and significant.

As mentioned earlier in Section 2.1, Garmaise (2011) discusses three major time-series changes in the enforcement of non-compete agreements. Texas decreased the enforceability of non-compete agreements in 1994, which decreased the non-compete enforcement score from 5 to 3. Florida increased enforcement in 1996, which increased the enforcement score from 7 to 9. Finally, Louisiana first decreased enforcement in 2001 and then revoked the rule in 2003. Its non-compete enforceability score first decreased from 4 to 0 and then returned to 4. Ertimur et al. (2018) extend Garmaise's index to the period of 1980-2013. In this study, *substantial* variation in non-compete agreement enforceability is defined as absolute changes in the enforcement index of at least 2 based on Garmaise's enforcement index over our sample period of 1992-2013. The categorical variable, denoted by $INEF$, equals 1 (-1) when the increase (decrease) in the enforceability index is more than 1 score (≥ 2) and 0 if the enforceability index remains unchanged. During our sample period of 1992–2013, substantial variation in the enforceability of non-compete agreements took place only in three states (i.e., in Texas, Florida, and Louisiana). More specifically, the exogenous shock, captured by $INEF$, takes the value of 1 for firms in Florida in 1997–2013 and -1 for firms in Texas in 1995–2013 and firms in Louisiana in 2002 and 2003. For all the other firm-years in our sample, the variable $INEF$ takes the value of 0.

In Equation (1), $X_{j,it}$ is a set of control variables including a list of such firm-specific characteristics variables as total assets (*TA*), market value of equity (*ME*), Tobin's Q (*TQ*), loss (*Loss*), leverage (*LEV*), profitability (*Profit*), tangibility (*Tangible*), cash holdings (*Cash*), and institutional ownership (*IO*). β_r , β_i , and β_s are the industry (we use SIC 2-digit industries to control for industry characteristics), year, and state fixed effects, respectively. We cluster the standard errors at the state level to correct for serial correlation within firms in a state.

3.2 Sample and data

Garmaise (2011) constructs an index to measure the enforceability of non-compete agreements in each state based on a survey of 12 questions from 1992–2004. The index varies from 0 to 9, with higher ranks indicating higher enforceability of non-compete agreements. Although laws governing the enforcement of non-compete agreements are largely static, Garmaise (2011) identifies three states that experienced significant shifts in the treatment of covenants not to compete during our sample period of 1992–2004. Specifically, Texas increased the requirements for enforceability of non-compete agreements in 1994, decreasing the enforceability index from 5 to 3; Florida strengthened the rights of employers in non-compete enforcement in 1996 and increased the enforcement score to 9 from an already high score of 7; in 2001, Louisiana decreased the enforceability of non-compete agreements from 4 to 0 and later retracted this ruling and thereby brought the score to 4. All of these changes in the enforceability index are at least 2 in absolute magnitude. Following Garmaise (2011), this study identifies exogenous shocks to this state-level enforceability based on substantial variations in the enforcement index (i.e., the absolute change in enforceability score greater than or equal to 2). This process provides a ranked measure of each state's non-compete agreement enforceability. Ertimur et al. (2018) hired three law student

research assistants to extend Garmaise's index to cover 1980–2013. Based on the updated index, only Texas, Florida and Louisiana experienced substantial variations during the sample period of 1992–2013.

From EDGAR, we obtain information about the state in which our sample firms are headquartered, starting from 1996. In Garmaise's (2011) sample, the states in which corporate headquarters are located change in only 5% of the firm-years. In cases where we are not able to identify an insider filing,⁸ we rely on information on the headquarters location in 1996. We then obtain all firm characteristics data from Compustat.

Next, we merge these data from EDGAR and Compustat with institutional ownership data from Thompson Reuters. As a proxy for firms' CSR performance, we use the KLD index, which presents a binary summary of positive and negative ESG ratings (strengths and concerns) in seven aspects: community, corporate governance, diversity, employee relations, the environment, human rights and products. It also incorporates controversial business issues, including alcohol, gambling, tobacco, firearms, military and nuclear power. In this paper, we focus on the overall positive CSR performance (as captured by *CSR_str*) and the overall negative CSR performance (as captured by *CSR_con*) in addition to the overall CSR performance (as captured *CSR_net*) of our sample firms.

The state variable represents the location of headquarters, which can be obtained through EDGAR. Since EDGAR starts in 1996, we assume that the headquarters location remained the same as in 1996 during the period of 1992–1995. Empirically, few firms change their headquarters. For example, in Garmaise's sample, only approximately 5% of firms relocated their headquarters to other states during the period of 1992–2004. Several enforceability variations in non-compete agreements have occurred throughout the United States in recent years. As mentioned earlier, for

⁸ When available, we use the addresses from SEC filings (specifically insider filings in Thomson) to determine the location of headquarters.

the period 1992–2004, Garmaise (2011) documents four exogenous shocks to the enforceability of non-compete agreements in three states: Texas, Florida, and Louisiana. Ertimur et al. (2018) further document no other substantial variations across states in the enforceability of non-compete agreements in the period of 2004–2013.

After we exclude firms with missing data for our dependent and independent variables, the final sample consists of 29,214 firm-year observations for the period of 1992–2013. All continuous variables are winsorized at their 1st and 99th percentiles to exclude the effect of outliers. Table 1 describes all the variables used in our study.

[Insert Table 1 about here]

3.3. Descriptive statistics

Table 2 provides the distributional properties for our sample. Panel A outlines the sample distribution by fiscal year throughout the sample period. As shown in Panel A, the number of firms in our sample increases steadily from 1992 to 2002, increases almost three times in 2003, and then remains relatively stable starting in 2003. The reason for the dramatic increase in firms is because the KLD database started to include small-cap U.S. companies and the Broad Market Social Index in 2003. Panel B shows the firm-year distribution of the enforceability index, denoted by *INEF*. Note in Panel B that the enforceability index (*INEF*) has the value of -1 if a state relaxes its legal enforcement of non-compete agreements in year t , has the value of +1 if a state starts to legally enforce non-compete agreements in a stricter way in year t , and has the value of 0 if a state does not change its legal enforcement in year t . As shown in Panel B, out of 29,215 firm-year observations during the sample period of 1992–2013, the state-level legal enforcement becomes

stricter ($INEF = 1$) for 955 firm-years, becomes relaxed ($INEF = -1$) for 2,482 firm-years, and does not change ($INEF = 0$) for 25,776 firm-years.

Panel C describes the firm-year distribution of the changes in the enforceability of non-compete agreements, while Panel D describes the firm-year distribution of the changes in enforceability in Texas, Florida and Louisiana. Panel C shows that the majority of firm-years are restricted by non-compete agreements, and only one sixth of the firm-years are free from non-compete agreements. Panel D shows that out of 29,214 firm-years, only 3,438 (= 2,483 + 955) experience changing non-compete enforceability.

[Insert Table 2 about here]

Table 3 reports the summary statistics for all variables. Similar to descriptive statistics reported in prior studies (Aobdia, 2019; Shaikh, 2015), the mean net CSR score is -0.37, and the median is 1, showing a right-skewed distribution of the overall CSR rating. The mean and median of *CNC* are approximately 4, with a reasonable variation of the variable, as reflected in the standard deviation of 2.28. The mean and median of *INEF* are approximately 0, with a reasonable variation of the variable, as reflected in the standard deviation of 0.34.

[Insert Table 3 about here]

4. Main Results

4.1 Baseline results

We begin our empirical analysis by investigating the relation between change in non-compete agreement enforceability (proxied by *INEF*) and firms' CSR performance. Table 4 reports the results of our baseline regression of CSR performance as the dependent variable on our test variable *INEF*. Three different measures of the dependent variable are constructed based on the ratings of CSR performance from the KLD dataset: CSR concerns (*CSR_con*), CSR strengths (*CSR_str*), and overall CSR performance (*CSR_net*). Our key variable of interest is *INEF*, which has the value of 1(-1) if the enforceability of non-compete agreements increases (decreases) compared to 1992 (the first year of Garmaise's enforcement index) and 0 if there is no change in enforceability from 1992 to year *t*. Columns 1 to 3 show the results of the baseline regression without controls but with the industry, year, and state fixed effects. Columns 4 to 6 display the results from the baseline regression with a set of controls, including the fixed effects.

[Insert Table 4 about here]

As shown in Table 4, the coefficients on *INEF* are negative and significant at the conventional level when the dependent variable is *CSR_str* (columns 2 and 5) or *CSR_net* (columns 3 and 6), while they are insignificant when the dependent variable is *CSR_con* (columns 1 and 4). These results suggest that an increase in the enforceability of non-compete agreements leads to a decrease in the KLD rating of positive and overall CSR performance (as reflected *CSR_str* and *CSR_net*, respectively), while it has no significant impact on negative CSR performance (as reflected in *CSR_con*). Specifically, the coefficient on *INEF* from the base model in column 3 is -0.522 and significant at less than the 1% level. This suggests that as non-compete agreement enforceability increases exogenously from no enforceability (*INEF* = 0) to a substantial

increase in enforceability ($INEF = 1$), a representative firm in our sample tends to substantially decrease its overall CSR performance by approximately -0.522 in terms of CSR_{net} . The coefficient on $INEF$ from the baseline regression (with controls) with CSR_{net} as the dependent variable (column 6) is -0.590, which could be interpreted in a similar way. While the coefficient may seem small in absolute terms, it is sizeable in relative terms compared to the average value of overall CSR strength (i.e., CSR_{net}), -0.37 (see Table 3). The above findings are in line with the prediction in H₁. The finding suggests that firms respond to the decreased threat of knowledge spillovers (associated with an increase in $INEF$) by decreasing their CSR engagement. In other words the enforceability of non-compete agreements plays an important strategic role in determining a firm's CSR performance and employee retention associated therewith. Stricter enforcement of non-compete agreements constrains employee mobility, decreases potential concerns about employee retention, and thus reduces a firm's incentive to exhibit better CSR performance, thereby leading us to observe a negative relation between $INEF$ and proxies for the overall and positive CSR performance captured by CSR_{str} and CSR_{net} , respectively.

Table 4 also reports the effect of the control variables on CSR performance. Following the CSR literature (Udayasankar, 2008; Flammer and Kacperczyk, 2019), these control variables account for firm characteristics such as firm size, growth or investment opportunity captured by Tobin's Q, loss, leverage, profitability, asset composition, and institutional ownership. In general, firm size and institutional ownership are significantly and negatively related to overall CSR performance, and this negative association also holds for CSR strengths and CSR concerns. Further, Tobin's Q is positively associated with CSR performance, as better CSR performance is a good signal to attract investment funds from external sources. Finally, leverage and loss are

marginally negatively associated with CSR performance, as they expose firms to higher financial risk.

4.2 Cross-sectional tests: Does peer pressure matter?

In this section, we further examine potential channels through which non-compete agreement enforceability influences CSR engagement at the firm level. To this end, our analysis focuses on whether and, if so, how peer pressure influences CSR performance interactively with the enforceability of non-compete agreements. Specifically, we use R&D intensity ($R\&D$) and the Herfindahl-Hirschman (industry concentration) index (HHI) as proxies for peer pressure faced by R&D-intensive firms and by firms in concentrated industries or competitive product markets, respectively. R&D-intensive firms face more peer pressure because they are more vulnerable to knowledge spillover risk when certain skilled employees leave them and join new competitive peers. We construct an indicator variable, $R\&D_H$, to identify high-R&D firms, which are firms with R&D expenditures above the sample median. $R\&D_H = 1$ (0) means that the firm's R&D intensity is above (below) the sample median, which indicates high (low) R&D intensity. We also construct an indicator variable, HHI_L , to identify low-HHI firms based on the bottom quartile of HHI. Note that HHI is a measure of industry concentration and hence can be viewed as an inverse measure of product market competition. Specifically, $HHI_L = 1$ means that a firm's industry concentration is below the 25th percentile within the sample, which means that this firm belongs to a highly competitive product market.

[Insert Table 5 about here]

In Table 5, to test H₂, we estimate augmented regressions with $R\&D_H$ and $INEF*R\&D_H$ (HHI_L and $INEF*HHI_L$) added to the baseline regression as in columns 1 to 3 (as in columns 4 to 6). As shown in column 3 of Table 5, the coefficient of $INEF*RD_H$ for CSR_{net} (overall CSR performance) is negative and highly significant (-0.483; $p = 0.000$). As shown in column 1, the coefficient on $INEF*RD_H$ for CSR_{con} (negative CSR performance) is significant with an expected positive sign at the 1% level, which is also consistent with our predictions. In column (2), however, the coefficient on $INEF*RD_H$ for CSR_{str} is insignificant. Overall, the above results are consistent with the prediction in H₂, suggesting that R&D-intensive firms tend to reduce their CSR engagement to a greater extent when faced with increased non-compete agreement enforceability. The rationale is that knowledge spillovers associated with employee mobility are more damaging and costlier for R&D-intensive firms; when stricter enforcement of non-compete agreements provides better protection of firm technology, patents and other knowledge, firms have less incentive to use CSR investment as a strategic tool to retain incumbent employees and to attract new employees.

As shown in columns 4 to 6, we find that the coefficients on $INEF_HHI_L$ are all negative and highly significant. The finding is consistent with our prediction in H₂, suggesting that firms in more competitive industries tend to decrease their CSR engagement to a greater extent when faced with increased non-compete agreement enforceability: Given an increase in the enforceability of non-compete agreements, firms in highly competitive industries are more sensitive to employee mobility. Accordingly, such firms tend to decrease (increase) their CSR performance to a larger extent when stricter non-compete agreement enforceability constrains employee mobility and the associated knowledge spillovers.

4.3 Sensitivity checks

As our first sensitivity test, we use a continuous measure of non-compete agreement enforceability in lieu of a categorical measure, such as *INEF*, to further examine whether the enforcement level of non-compete agreements has an influence on a firm's CSR engagement. Specifically, we replace *INEF* in Equation (1) with *CNC* (covenants that do not compete). As a continuous measure of *CNC*, we use the non-compete agreement enforceability index developed by Ertimur et al. (2018). Ertimur et al. (2018) update the enforceability index based on Garmaise (2011) for the period of 1992–2004 and further construct the index for the extended period of 1980–2013. While *INEF* is a categorical variable that only has the values, -1, 0, and +1, *CNC* is a continuous variable ranging from 0 to 9 (Ertimur et al., 2018). We include the same control variables as in Equation (1) as well as the industry, year, and state fixed effects.

[Insert Table 6 about here]

Table 6 reports the results of regressions using *CNC* as an alternative proxy for the enforceability of non-compete agreements. As shown in columns 3 and 6, where overall CSR performance (*CSR_str*) is used as the dependent variable, the coefficients on *CNC* are negative (-0.031 and -0.028, respectively) and significant at less than the 5% level. The same is true of the coefficients on *CNC* in columns 2 and 5 (-0.035 and -0.030, respectively). These results are consistent with the prediction in H₁, reconfirming our main result, that is, the negative association between non-compete agreement enforceability and firm-level CSR performance.

As our second sensitivity test, we conduct a robustness check on the relation between knowledge spillover and CSR performance across different industries. Specifically, firms

operating in high-technology industries are likely to experience higher growth and more innovation, which makes them more susceptible to knowledge spillover risk when certain skilled employees leave them to join competing firms. Accordingly, we test whether the relation between knowledge spillover and CSR performance is more pronounced in high-tech industries than in other industries. Similar in spirit to the comparison between high-tech versus non-high-tech industries, we expect that firms operating in the wholesale and retail trade industries are less likely to be susceptible to knowledge spillover risk. As such, we expect the effect of knowledge spillover (associated with non-compete agreement enforceability) on CSR performance to be relatively weak or insignificant.

We construct an indicator variable *HighTech* to differentiate between firms belonging to one of the high-technology industries (denoted by SIC 2832–2837, 3611–3614, 3620–3630, 3650–3653, 3660–3670, 4811–4823, 4831–4900, 7369–7380, 3674, and 3695) and all other firms. We also construct an indicator variable *Trade* that equals 1 for firms in the wholesale and retail trade industries (denoted by SIC 5000–5999) and 0 otherwise. To capture the joint effect of *INEF* and *HighTech* and that of *INEF* and *Trade*, we include the interaction terms *INEF*HighTech* and *INEF*Trade* in our baseline regression in Equation (1). Table 7 presents the estimated results of these augmented regressions.

[Insert Table 7 about here]

As shown in columns 2 and 3, where *CSR_str* and *CSR_net* are used, respectively, as the dependent variables, we find that the coefficients on *HighTech* are positive and highly significant, suggesting that firms in high-tech industries tend to engage more in CSR investment. More

importantly, consistent with our expectation, we find that the coefficient on *INEF*HighTech* is negative and significant in columns 2 and 3. This finding suggests that firms in high-tech industries rely on more aggressive CSR engagement as a strategy to retain incumbent skilled employees and recruit new employees. As expected, however, we find that the coefficients on *Trade* and *INEF*Trade* are all insignificant except that the coefficient on *Trade* is negative in column 4. The insignificant coefficients on *INEF*Trade* indicate that firms in the wholesale and retail trade industries are not susceptible to knowledge spillovers associated with employ mobility. In addition, the significantly negative coefficient on *Trade* in column 4 is in line with the view that firms in these trade industries are exposed to negative SCR performance to a greater extent than firms in other industries.⁹

5. Conclusion

Motivated by the finding of prior research that CSR could be an effective corporate governance tool, this study investigates a hitherto under-researched question of whether firms strategically engage in CSR practices to retain employees when faced with the risk of knowledge spillover. In so doing, we take advantage of staggered changes in non-compete agreement enforceability at the U.S. state level as an exogenous shock to the mobility of skilled labor and the knowledge spillover associated therewith. We construct a non-compete agreement enforceability index for our sample period of 1992–2013, which goes beyond Garmaise’s (2011) sample period of 1992–2004.

The results of various regressions reveal that stricter enforceability of non-compete agreements leads to poorer CSR engagement, which is consistent with the view that firms

⁹ As an additional analysis, we also test the main result for firms that belong to the agriculture, oil and gas, and pharmaceutical and healthcare industries. The results (not tabulated) are comparable to those reported for the wholesale and retail trade industries.

strategically use CSR engagement to retain their skilled employees. The results of our cross-sectional tests support the prediction that the strategic role of CSR performance is more pronounced for R&D-intensive firms and firms in highly competitive industries. Specifically, firms with more peer pressure (firms that are R&D intensive and in highly competitive industries) reduce (improve) their CSR performance to a greater extent when faced with increased (decreased) enforceability of non-compete agreements. Finally, we find a negative association between the absolute enforcement level of non-compete agreements and firms' CSR performance. We also find that firms in high-tech industries (wholesale and retail trade industries) tend to curtail (increase) their CSR engagement to a greater extent when faced with increased enforceability of non-compete agreements.

Our study adds to the CSR literature by providing useful insights into the strategic role of CSR investment in retaining skilled employees and protecting proprietary information from competitive peers. Moreover, the negative association observed between the absolute enforcement level of non-compete agreements and firms' CSR performance lends further support to the strategic role of CSR performance. In addition, the use of cross-state variations in non-compete agreement enforceability as an exogenous shock helps to strengthen our inferences on the impact of knowledge spillover risk on CSR engagement. Given the scarcity of causal evidence on this issue, we recommend further research in this direction.

Appendix

Questions to evaluate the enforcement level of non-compete agreements (Garmaise, 2011)

- Q1: Is there a state statute of general application that governs the enforceability of covenants not to compete? States that enforce non-competition agreements outside a sale-of-business context receive a score of 1.
- Q2: What is an employer's protectable interest and how is it defined? States in which the employer can prevent the employee from future independent dealings with all the firm's customers, not merely with the customers with whom the employee had direct contact, receive a score of 1.
- Q3: What must the plaintiff be able to show to prove the existence of an enforceable covenant not to compete? Laws that place greater weight on the interests of the firm relative to those of the former employee are above the threshold.
- Q4: Does the signing of a covenant not to compete at the inception of the employment relationship provide sufficient consideration to support the covenant? States for which the answer to Question 4 is clearly "Yes" are above the threshold.
- Q5: Will a change in the terms and conditions of employment provide sufficient consideration to support a covenant not to compete entered into after the employment relationship has begun? States for which the answer to Question 5 is clearly "Yes" are above the threshold.
- Q6: Will continued employment provide sufficient consideration to support a covenant not to compete entered into after the employment relationship has begun? States for which the answer to Question 6 is clearly "Yes" are above the threshold.
- Q7: What factors will the court consider in determining whether time and geographic restrictions in the covenant are reasonable? Jurisdictions in which courts are instructed not to consider economic or other hardships faced by the employee are above the threshold.
- Q8: Who has the burden of proving the reasonableness or unreasonableness of the covenant not to compete? States in which the burden of proof is clearly placed on the employee are above the threshold.
- Q9: What type of time or geographic restrictions has the court found to be reasonable? Unreasonable? Jurisdictions in which 3-year statewide restrictions have been upheld receive a score of 1.
- Q10: If the restrictions in the covenant not to compete are unenforceable because they are overbroad, are the courts permitted to modify the covenant to make the restrictions narrower and to make the covenants enforceable? States for which the answer to Question 10 is clearly "Yes" are above the threshold.
- Q11: If the employer terminates the employment relationship, is the covenant enforceable? States for which the answer to Question 11 is clearly "Yes" are above the threshold.
- Q12: What damages may an employer recover and from whom for breach of a covenant not to compete? If, in addition to lost profits, there is a potential for punitive damages against the former employee, the state receives a score of 1. States that explicitly exclude consideration of the reasonableness of the contract from the calculation of damages are also above the threshold.

Appendix – Continued
 Noncompete agreement enforcement level

State	CNC Index	State	CNC Index
Alabama (1992–2013)	5	Mississippi (1992–2008)	4
Alaska (1992–2013)	3	Mississippi (2009–2013)	5
Arizona (1992–2013)	3	Missouri (1992–2013)	7
Arkansas (1992–2013)	5	Montana (1992–2013)	2
California (1992–2013)	0	Nebraska (1992–2013)	4
Colorado (1992–2011)	2	Nevada (1992–2013)	5
Colorado (2012–2013)	3	New Hampshire (1992–2013)	2
Connecticut (1992–2013)	3	New Jersey (1992–2013)	4
D.C. (1992–2013)	7	New Mexico (1992–2013)	2
Delaware (1980–2013)	6	New York (1992–2013)	3
Florida (1992–1996)	7	North Carolina (1992–2013)	4
Florida (1997–2013)	9	North Dakota (1992–2013)	0
Georgia (1992–2004)	5	Ohio (1992–2013)	5
Georgia (2005–2013)	6	Oklahoma (1992–2013)	1
Hawaii (1992–2006)	3	Oregon (1992–2013)	6
Hawaii (2007–2013)	4	Pennsylvania (1992–2013)	6
Idaho (1992–2008)	6	Rhode Island (1980–2013)	3
Idaho (2009–2013)	7	South Carolina (1992–2013)	5
Illinois (1992–2013)	5	South Dakota (1992–2013)	5
Indiana (1992–2013)	5	Tennessee (1992–2013)	7
Iowa (1992–2013)	6	Texas (1992–1994)	5
Kansas (1992–2007)	6	Texas (1995–2013)	3
Kansas (2008–2013)	7	Utah (1992–2013)	6
Kentucky (1992–2013)	6	Vermont (1992–2013)	5
Louisiana (1992–2001)	4	Virginia (1992–2005)	3
Louisiana (2002–2003)	0	Virginia (2006–2013)	4
Louisiana (2004–2013)	4	Washington (1992–2013)	5
Maine (1992–2013)	4	West Virginia (1992–1991)	3
Maryland (1992–2013)	5	West Virginia (1992–2013)	2
Massachusetts (1992–2013)	6	Wisconsin (1992–2013)	3
Michigan (1992–2013)	5	Wyoming (1992–2013)	4
Minnesota (1992–2013)	5		

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Table 1
Variable Description

Variables	Description
CSR_con	CSR concerns from KLD ESG ratings
CSR_str	CSR strengths from KLD ESG ratings
CSR_net	Net CSR performance, calculated as CSR_str minus CSR_con
CNC	The enforceability index of non-compete agreements from Ertimur et al. (2018). They construct an enforceability index based on Garmaise (2011) and extend the time period to 1980-2013. States not enforcing non-compete agreements have an enforcement level of 0, and states strongly enforcing non-compete agreements have an enforcement level of 9.
INEF	Equals -1 if a state relaxed its non-compete enforcement laws in year t, 0 if a state did not change its non-compete enforcement laws in year t, and 1 if a state implemented stricter non-compete enforcement laws in year t
TA	Natural logarithm of total assets in year t
ME	Market value of equity, calculated as the number of common shares outstanding multiplied by fiscal year closing price in year t
TQ	Tobin's Q, defined as market value of equity plus book value of debt (long-term debt plus short-term debt) scaled by book value of total assets in year t
Loss	Equals 1 if income before extraordinary items is negative and 0 otherwise
LEV	Leverage ratio, calculated as short-term debt plus long-term debt scaled by total assets in year t
Profit	Profitability, calculated as operation income before depreciation divided by total assets in year t
Tangible	Total property, plant and equipment divided by total assets in year t
Cash	Cash and short-term investments divided by total assets in year t
IO	Institutional ownership, defined as a percentage of shares owned by institutions in year t
R&D	R&D intensity, calculated as R&D expenditure divided by total sales in year t
HHI	The Herfindahl Index
R&D _H	An indicator variable that is equal to 1 if R&D expenses scaled by total assets is above the median and 0 otherwise
HHI _L	An indicator variable that is equal to 1 if the Herfindahl index is in the sample bottom quartile and 0 otherwise

Table 2
Summary Statistics

Panel A

Year Distribution

Fiscal Year	Freq.	Percent	Cum.
1992	228	0.78	0.78
1993	235	0.80	1.58
1994	240	0.82	2.41
1995	404	1.38	3.79
1996	429	1.47	5.26
1997	437	1.50	6.75
1998	453	1.55	8.30
1999	460	1.57	9.88
2000	434	1.49	11.36
2001	803	2.75	14.11
2002	835	2.86	16.97
2003	2,227	7.62	24.59
2004	2,283	7.81	32.41
2005	2,223	7.61	40.02
2006	2,211	7.57	47.59
2007	2,184	7.48	55.06
2008	2,261	7.74	62.80
2009	2,288	7.83	70.63
2010	2,317	7.93	78.57
2011	2,161	7.40	85.96
2012	2,171	7.43	93.39
2013	1,930	6.61	100.00
Total	29,214	100.00	

Panel B

Summary Statistics of variations in non-compete enforceability

INEF	Freq.	Percent	Cum.
-1	2,483	8.50	8.50
0	25,776	88.23	96.73
1	955	3.27	100.00
Total	29,214	100.00	

Table 2 – Continued

Panel C

Summary Statistics of non-compete enforceability

CNC	Freq.	Percent	Cum.
0	5,438	18.61	18.61
1	265	0.91	19.52
2	1,125	3.85	23.37
3	6,957	23.81	47.19
4	3,842	13.15	60.34
5	5,223	17.88	78.22
6	4,644	15.90	94.11
7	765	2.62	96.73
9	955	3.27	100.00
Total	29,214	100.00	

Panel D

Summary Statistics of variations in non-compete enforceability in Texas, Florida and Louisiana

INEF	-1	0	1	Total
FL	0	45	955	1,000
LA	26	239	0	265
TX	2,457	48	0	2,505
Total	2,483	332	955	3,770

Table 3
Descriptive Statistics

Variable	n	Mean	S.D.	Min	25%	Med.	75%	Max
CSR_con	29,214	1.88	1.91	0.00	1.00	1.00	3.00	18.00
CSR_str	29,214	1.51	2.32	0.00	0.00	1.00	2.00	22.00
CSR_net	29,214	-0.37	2.47	-12.00	-2.00	1.00	1.00	19.00
INEF	29,214	-0.05	0.34	-1.00	0.00	0.00	0.00	1.00
CNC	29,214	3.65	2.28	0.00	3.00	4.00	5.00	9.00
TA	29,214	7.34	1.72	3.16	6.07	7.25	8.43	13.20
TQ	29,214	1.43	1.45	0.01	0.51	0.99	1.81	14.99
Loss	29,214	0.20	0.40	0.00	0.00	0.00	0.00	1.00
LEV	29,214	2.32	4.09	-14.71	0.50	1.11	2.36	37.95
Profit	29,214	0.02	0.14	-1.73	0.01	0.04	0.08	0.29
Tangible	29,214	0.24	0.24	0.00	0.05	0.16	0.37	0.92
Cash	29,214	0.18	0.20	0.00	0.03	0.09	0.25	1.00
IO	29,214	0.66	0.25	0.00	0.49	0.70	0.85	1.27

This table reports the descriptive statistics of the variables defined in Table 1.

Table 4
Baseline Results

Model	(1)	(2)	(3)	(4)	(5)	(6)
Variable	CSR_con	CSR_str	CSR_net	CSR_con	CSR_str	CSR_net
INEF	-0.008 [0.958]	-0.530* [0.053]	-0.522*** [0.001]	-0.186 [0.571]	-0.776 [0.158]	-0.590** [0.017]
TA				0.602*** [0.000]	0.891*** [0.000]	0.289*** [0.000]
TQ				0.026** [0.039]	0.171*** [0.000]	0.145*** [0.000]
Loss				0.124*** [0.008]	-0.047 [0.308]	-0.171*** [0.001]
LEV				-0.008 [0.127]	-0.011* [0.054]	-0.002 [0.781]
Profit				-0.172 [0.314]	0.245 [0.101]	0.417** [0.035]
Tangible				-0.076 [0.698]	0.259 [0.233]	0.335 [0.181]
Cash				0.431*** [0.000]	0.739*** [0.000]	0.308 [0.155]
IO				-0.559*** [0.000]	-1.067*** [0.000]	-0.508*** [0.000]
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
State FE	Yes	Yes	Yes	Yes	Yes	Yes
Clustered by State	Yes	Yes	Yes	Yes	Yes	Yes
N	29,214	29,214	29,214	29,214	29,214	29,214
Adjusted R ²	0.200	0.074	0.126	0.381	0.343	0.156

This table reports the results of the cross-sectional test of the association between the enforceability of non-compete agreements and firm CSR performance (CSR_con, CSR_str, CSR_net) and whether adding financial characteristics significantly increases the explanatory power (adjusted R²). All variables are defined in Table 1, where all continuous variables are winsorized at the 1st and 99th percentiles. Industry fixed effects (FE) are determined using SIC 2-digit industries. P-values are reported in parentheses and are based on robust standard errors (clustered by state). ***, **, and * denote significance at $p < 0.01$, $p < 0.05$, and $p < 0.10$, respectively.

Table 5
Cross-sectional study of peer pressure

Model	(1)	(2)	(3)	(4)	(5)	(6)
Variable	CSR_con	CSR_str	CSR_net	CSR_con	CSR_str	CSR_net
INEF	-0.671*** [0.001]	-0.884* [0.069]	-0.213 [0.500]	-0.163 [0.630]	-0.656 [0.274]	-0.493* [0.079]
INEF*R&D _H	0.601*** [0.001]	0.118 [0.223]	-0.483*** [0.000]			
R&D	-0.048*** [0.000]	-0.024* [0.053]	0.024** [0.042]			
INEF*HHI _L				-0.126** [0.023]	-0.562*** [0.003]	-0.436*** [0.010]
HHI				-0.104 [0.267]	-0.078 [0.357]	0.026 [0.825]
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
State FE	Yes	Yes	Yes	Yes	Yes	Yes
Clustered by State	Yes	Yes	Yes	Yes	Yes	Yes
N	29,214	29,214	29,214	29,214	29,214	29,214
Adjusted R ²	0.384	0.344	0.157	0.381	0.345	0.157

This table reports the results of the cross-sectional test of the association between the interaction effects of R&D intensity and market competitiveness with non-compete agreement enforceability on firms' CSR performance. High-R&D firms ($R\&D_H$) is an indicator variable that equals one if a firm's R&D expenditure is above the median and zero otherwise. Low-HHI firms (HHI_L) is an indicator variable that equals one if a firm's HHI is in the bottom quartile of HHI and zero otherwise. As HHI measures industry concentration, it can be viewed as an inverse measure of product market competition. Hence, $HHI_L = 1$ means that a firm's industry concentration is below the 25th percentile within the sample or industry competition is in the top quartile within the sample. All remaining variables are defined in Table 1, and continuous variables are winsorized at the 1st and 99th percentiles. Industry fixed effects (FE) are determined using SIC 2-digit industries. P-values are reported in parentheses and are based on robust standard errors (clustered by state). ***, **, and * denote significance at $p < 0.01$, $p < 0.05$, and $p < 0.10$, respectively. The controls include the same set of controls as in Table 4.

Table 6
Cross-sectional study of enforceability index

Model	(1)	(2)	(3)	(4)	(5)	(6)
Variable	CSR_con	CSR_str	CSR_net	CSR_con	CSR_str	CSR_net
CNC	-0.004 [0.714]	-0.035** [0.024]	-0.031** [0.033]	-0.002 [0.783]	-0.030** [0.010]	-0.028** [0.047]
TA				0.606*** [0.000]	0.891*** [0.000]	0.285*** [0.000]
LEV				-0.009* [0.070]	-0.010 [0.101]	-0.0001 [0.949]
TQ				0.023 [0.107]	0.174*** [0.000]	0.151*** [0.000]
Loss				0.116*** [0.005]	-0.034 [0.404]	-0.150*** [0.004]
Profit				-0.187* [0.097]	0.240* [0.075]	0.427*** [0.009]
Tangible				-0.040 [0.811]	0.181 [0.294]	0.221 [0.322]
Cash				0.435*** [0.000]	0.885*** [0.000]	0.450** [0.011]
IO				-0.559*** [0.000]	-1.054*** [0.000]	-0.496*** [0.000]
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
State FE	Yes	Yes	Yes	Yes	Yes	Yes
Clustered by State	Yes	Yes	Yes	Yes	Yes	Yes
N	29,214	29,214	29,214	29,214	29,214	29,214
Adjusted R ²	0.184	0.059	0.110	0.371	0.333	0.140

This table reports the results of the cross-sectional test of the association between absolute non-compete agreement enforceability and firms' CSR performance. *CNC* is the enforceability index, reconstructed by Ertimur et al. (2018) based on Garmaise (2011). All variables are defined in Table 1, and all continuous variables are winsorized at the 1st and 99th percentiles. Industry fixed effects (FE) are determined using SIC 2-digit industries. P-values are reported in parentheses and are based on robust standard errors (clustered by state). ***, **, and * denote significance at $p < 0.01$, $p < 0.05$, and $p < 0.10$, respectively.

Table 7
Cross-sectional sensitivity tests in different industries

	(1)	(2)	(3)	(4)	(5)	(6)
	CSR_con	CSR_str	CSR_net	CSR_con	CSR_str	CSR_net
INEF	-0.162 [0.400]	-0.779 [0.178]	-0.617 [0.146]	-0.164 [0.377]	-0.808 [0.146]	-0.644 [0.117]
INEF*HighTech	-0.083 [0.212]	-0.516** [0.042]	-0.433** [0.035]			
HighTech	-0.061 [0.479]	0.283*** [0.002]	0.344*** [0.000]			
INEF*Trade				-0.028 [0.625]	-0.090 [0.465]	-0.062 [0.711]
Trade				-0.178** [0.042]	-0.166 [0.182]	0.012 [0.927]
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
State FE	Yes	Yes	Yes	Yes	Yes	Yes
Clustered by state	Yes	Yes	Yes	Yes	Yes	Yes
N	29,214	29,214	29,214	29,214	29,214	29,214
Adjusted R ²	0.301	0.307	0.116	0.301	0.305	0.113

This table reports the results of the cross-sectional test of the association between the enforceability of non-compete agreements and firm CSR performance for two industries. The dummy variable *HighTech* indicates that a firm belongs to high-tech industries (denoted by SIC 2832–2837, 3611–3614, 3620–3630, 3650–3653, 3660–3670, 4811–4823, 4831–4900, 7369–7380, 3674, and 3695), and *INEF*HighTech* is the interaction term between *INEF* and *HighTech*. The dummy variable *Trade* indicates that a firm belongs to the wholesale and retail trade industries (denoted by SIC 5000–5999), and *INEF*Trade* is the interaction term between *INEF* and *Trade*. All remaining variables are defined in Table 1. P-values are reported in parentheses and are based on robust standard errors (clustered by state). ***, **, and * denote significance at $p < 0.01$, $p < 0.05$, and $p < 0.10$, respectively. The controls include the same set of controls as in Table 4.