Exit or Voice? Divestment, Activism, and Corporate Social Responsibility

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Abstract :
Should investors screen out non-responsible firms from their portfolio, or invest in them and engage with the leadership? This paper evaluates the relative effectiveness of those exit and voice strategies to pressure firms to adopt more sustainable business practices and it uncovers the incentives directors and executives respond to. First, I propose a novel measure of mutual funds' exit and voice, based on their portfolio holdings and votes at companies' meetings. Then, in a shift-share design, I use large investor redemptions as plausibly exogenous shocks to funds' influence to identify the impact of each strategy on firms' anti-social behavior, measured by the probability of having a public controversy. The threat of exit does not discipline financially constrained firms, ruling out a lower cost of capital as motivating pro-social efforts. However, it is effective when the executives' pay is highly sensitive to their firm's value. I show that voice funds improve firms' behavior, especially when the board nears new elections. Taken together, my results point to the leadership's personal concerns as driving pro-social change when shareholders ask for it.