Stay or Sell? 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 management? This paper evaluates the relative effectiveness of those exit (divestment) and voice (activism) strategies to incentivize firms to adopt more sustainable business practices. Using data on Mutual Funds, I find that activism is more effective than the threat of divestment to limit anti-social behavior of US firms. I propose a novel quarterly classification of Mutual Fund companies as divestor, activist, both, or none, based on their portfolio holdings and votes at companies' meetings on Corporate Social Responsibility (CSR) proposals. Using large redemptions as plausibly exogenous shocks to funds' influence, I identify the impact of each group on firms' anti-social behavior, measured by the probability of having a social controversy reported in the media. The main result is that only activist funds successfully pressure firms to behave better. I find that when such a fund is forced to sell 1% of a firm's equity, it increases the probability of controversy in the next 10 months by 1%. The effect is concentrated among firms with the lowest level of CSR: for them, the effect increases to 5%, and lasts for more than 15 months. On the contrary, I find no evidence that divestor funds reduce firms' anti-social behavior. Finally, I do not find any spillover effect from pro-social activism to environmental and governance controversies.