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 management? This paper evaluates the relative effectiveness of these exit and voice strategies and uncovers the conditions under which each strategy is most impactful. Using a classification framework based on US mutual funds' portfolio holdings and votes on S-related shareholder proposals, I show that voice funds generally do better than exit funds when it comes to curtailing firms' anti-social behavior. The exit strategy relies on the threat of lower stock prices and is effective only at firms with high CEO wealth-performance-sensitivity. Voice funds threaten directors' reelection, and are thus more effective in general, especially when elections are approaching. Taken together, my results point to the career concerns of the leadership as driving pro-social change when shareholders demand it.