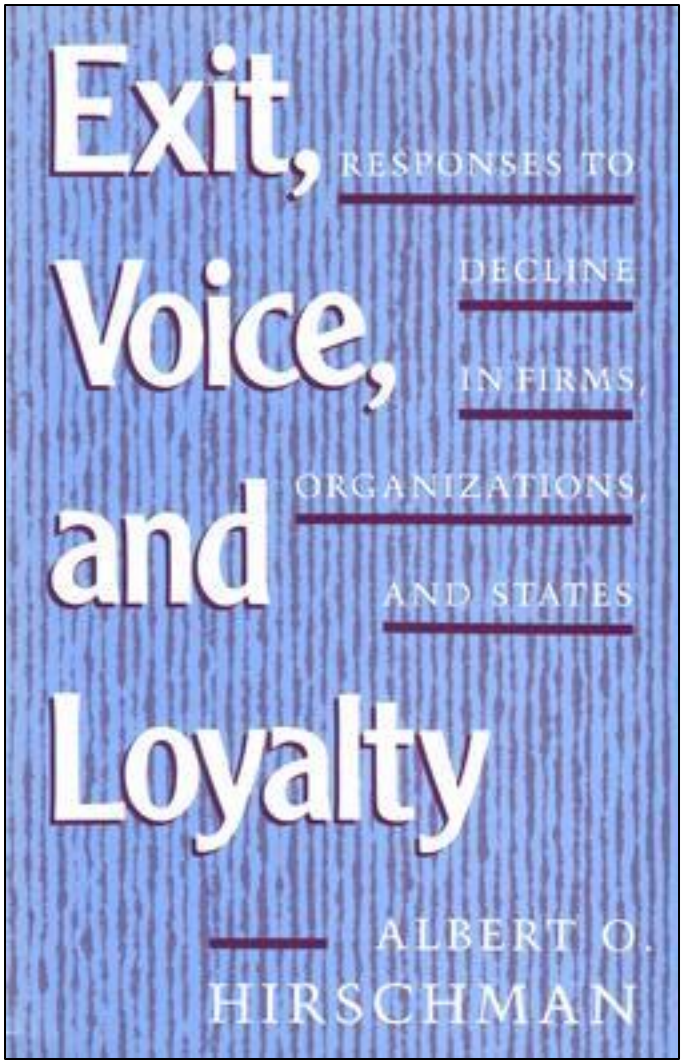
Discussion of Saint-Jean (2024)

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

Discussant: Sangmin Simon Oh (Columbia Business School)

SFS Cavalcade Asia-Pacific 2024

Background: Exit vs. Voice (Hirschman, 1970)



Background: Exit vs. Voice (Broccardo, Hart, and Zingales, 2022)

Exit versus Voice

Eleonora Broccardo

Università di Trento

Oliver Hart

Harvard University

Luigi Zingales

University of Chicago

We study the relative effectiveness of exit (divestment and boycott) and voice (engagement) strategies in a world where companies generate externalities and some agents care about the social impact of their decisions. We show that if the majority of investors are even slightly socially responsible, voice achieves the socially optimal outcome. In contrast, exit does not unless everybody is significantly socially responsible. If the majority of investors are purely selfish, exit is a more effective strategy, but neither strategy generally achieves the first best. We also show that exit can sometimes reduce social welfare.

Recap

Objective

- Evaluate the effectiveness of exit (divestment) and voice (activism) strategies in promoting corporate social responsibility (CSR)

Approach

- Novel classification of mutual funds based on (1) holdings and (2) voting behavior
- Large mutual fund redemptions as shocks to measure the impact on CSR outcomes

Result

- Voice funds are more effective: 1% reduction in equity held by voice funds increases social controversies by 30%
- Exit is less effective overall but works in firms with high CEO wealth-performance sensitivity

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Plan for Discussion

1. Are we underestimating the effect of divestment?
2. Cost of capital and threat of exit
3. Extension to other investors and other firm dimensions

Point 1. Are we underestimating the effect of divestment?

Recap: Empirical Specification

Controversies depend on past quarter exit pressure and voice:

$$\text{Controversy}_{n,t} = \text{Exit}_{n,t-1} + \text{Voice}_{n,t-1} + \tilde{\delta}_t + \alpha_n + \tilde{u}_{n,t}.$$

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- One stylized model: $\text{Controversy}_{n,t} = \gamma_n X_t + \epsilon_{n,t}$
  - X_t: systematic factors (e.g. new EPA regulations, oil price shocks)
  - γ_n: firm-specific sensitivity (e.g. oil vs. software)
  - $\epsilon_{n,t}$: idiosyncratic shocks (e.g. whistleblower revelation)

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Taking two-period differences and using instruments:

$$\text{Controversy}_{n,t+2} - \text{Controversy}_{n,t} = \beta_{\text{Exit}} \overbrace{(\text{Exit}_{n,t+1} - \text{Exit}_{n,t-1})}^{\text{Instrumented by } Z^{\text{Exit}}_{n,t}} + \beta_{\text{Voice}} \underbrace{(\text{Voice}_{n,t+1} - \text{Voice}_{n,t-1})}_{\text{Instrumented by } Z^{\text{Voice}}_{n,t}} + \delta_{t+2} + u_{n,t+2}, \quad (2)$$

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Instrument: Changes in exposure to exit and voice funds due to large redemptions:

$$\begin{cases} Z^{\text{Exit}}_{n,t} = \sum_i MFHS_{n,i,t} \times \mathbf{1} \cdot (\text{Exit Fund}_{i,t}) \\ Z^{\text{Voice}}_{n,t} = \sum_i MFHS_{n,i,t} \times \mathbf{1} \cdot (\text{Voice Fund}_{i,t}) \end{cases}$$

where:

$$\text{Flows}_{i,t} = \frac{\text{TNA}_{i,t} - \text{TNA}_{i,t-1} \times (1 + \text{Return}_{i,t})}{\text{TNA}_{i,t-1}} \qquad MFHS_{n,i,t} = \text{Flows}_{i,t} \times \text{Ownership}_{n,i,t-1}.$$

Measuring Threat of Exit

Measure of threat of exit faced by firm n from its mutual fund shareholders:

$$\text{Exit}_{n,t} = \sum_i \text{Ownership}_{i,t,n} \times \mathbf{1} \cdot \Big(\underbrace{\text{Exit Fund}_{i,t}}_{\beta_{S,i,t}>0 \ \& \ \text{No index}} \Big)$$

ii. Firm-level statistics					
Quarter with at least one controversy (0/1,×100)	2.37	0	0	0	15.21
Overall fund ownership (%)	19.84	18.81	14.14	24.06	8.32
Exit fund ownership (%)	3.04	2.28	1.11	4.15	2.77
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Suggestion 1a

Split the sample into high and low mutual fund ownership and estimate the exit effect separately (is exit more powerful when "exit funds" threats carry more weight?)

Suggestion 1b

Weigh each "exit" fund's ownership by its likely price impact in constructing $Exit_{n,t}$

Point 2. Cost of Capital and Threat of Exit

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  - Firms with low r experience a larger proportional increase in cost of capital.

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Suggestion 2

Clarify why firms with high cost of capital would be expected to respond more strongly

Point 3. Extension to Other Investors and Other Firm Dimensions

Extension #1: Beyond Mutual Funds

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4. **Room for Coordination**
   - Mutual Funds: Limited ability to coordinate
   - Other 13F Investors: More room for coordinated engagement ⇒ Both

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4. **Stakeholder Pressure**
   - Social controversies: Often driven by employees, customers, media
   - Climate concerns: Broader stakeholders (regulators, future generation) ⇒ Both

Final Thoughts

- Author studies when ESG-motivated investors should use divestment (“exit”) or activism (“voice”) in promoting corporate social responsibility.

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  - Great data exercise that integrates multiple strands in the literature
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- **Some questions prompted by the paper for the future:**
  - What are the relative costs of exit vs. voice strategies for investors, and how do these costs affect their choice of engagement strategy?
  - How can policy and market structure be designed to optimize the mix of exit and voice in ESG investing? (e.g., proxy voting rules, disclosure requirements)