CULLING BLACK SHEEP TO BETTER THE FLOCK?
INSTITUTIONAL ACTIVISM, FIRM CENSORSHIP AND
PEERS’ CORPORATE SOCIAL RESPONSIBILITY OUTCOMES

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Draft: March 10, 2015

ABSTRACT
This paper examines how censorship or ‘blacklisting’ of portfolio firms by a socially responsible
institutional investor leads to improved corporate social responsibility (CSR) efforts by non-
culpable peer firms in the investor’s portfolio. Extending research on institutional activism, we
offer the first systematic study of the effect of censorship, defined as divestments—which
incorporate public naming and shaming and hence, delegitimization—of firms that are deemed
culpable of CSR transgressions. We suggest that censorship draws peer firms’ attention to the
salient issues and preferences of socially conscious investors, and thereby activates
improvements in CSR efforts of peer firms. Our findings based on the Norwegian sovereign
wealth fund’s censorship announcements and its portfolio firms’ CSR ratings over the period
1998-2011 confirm our theory. Moreover, we find that the peer effect of censorship—by way of
drawing attention to and improving CSR efforts—is enhanced when peer firms identify more
closely with the institutional investor’s portfolio owing to higher ownership stakes, and in the
presence of others forms of shareholder activism directed at peer firms. Our study unites two
separately evolving literatures on institutional activism and spillover effects across firms that
share a category space, and provides evidence of a preemptive CSR strategy. From a policy
standpoint, our findings suggest that criticism of censorship and the privileged use of shareholder
dialogues alone to achieve the desired CSR outcomes may be misguided and should be revisited.

Key words: corporate social responsibility; institutional activism; censorship, attention based
view; spillover effects; non-culpable firms, delegitimacy; Norwegian sovereign wealth fund
Introduction

Recent years have witnessed a number of transgressions in corporate responsibility eliciting intense public criticism from the media (King & Soule, 2007), subversive social activism through protests and boycotts (King, 2008), and divestments by socially conscious institutional investors (Soule, Swaminathan, & Tihanyi, 2014). Such activism has resulted in the delegitimization of not only culpable firms but also other non-culpable firms having varying degrees of relatedness to the targeted firm. Indeed, a growing body of research within the realm of corporate misconduct and organizational crises has established the existence of negative spillover effects within a category of firms (Diestre & Rajagopalan, 2014; Jonsson, Greve, & Fujiwara-Greve, 2009; Paruchuri & Misangyi, 2014; Yue, Rao, & Ingram, 2013).

However, beyond documenting evidence of punitive outcomes experienced by non-culpable firms, such as the negative perceptions by investors (Diestre & Rajagopalan, 2014; Paruchuri & Misangyi, 2014) and the emergence of new industries (e.g. Hiatt, Sine, & Tolbert, 2009; Lounsbury, Ventresca, & Hirsch, 2003), research has been relatively silent regarding the broader field level outcomes of delegitimizing events. Specifically, there has been a theoretical oversight in terms of how non-culpable firms respond—especially by way of improving their conduct in the wake of a delegitimizing event befalling one of their peers. This oversight is troubling for theoretical and practical reasons. Theoretically, one might expect that punitive action taken against culpable firms sends a strong signal to bystander firms about the desirability of certain behaviors. Moreover, bystander firms are not cultural dopes, and are therefore, expected to exercise agency in order to minimize the pernicious effects of potential negative spillovers. From a practical standpoint, the lack of systematic theorizing and empirical inquiry into the nature and scope of non-culpable firms’ responses is puzzling despite many motivating
examples in the real world. The collapse of the Rana Plaza textile complex in Bangladesh that claimed thousands of workers’ lives in 2013 is a recent case in point. Big-box retailers such as Primark and JCPenny were accused (and hence delegitimized) as proponents for a low operating cost approach, engaging suppliers that compromised safe working conditions for Bangladeshi workers. Subsequent local protests that ensued impacted not only fashion retailers in the U.S. and Europe but also the entire apparel industry. Garment companies that were not directly involved in the disaster began to scrutinize their own outsourcing activities and supply chain operations as a response to avoid additional negative media attention (Associated Press, 2013).

In light of these observations, we depart from prior research that has focused primarily on the negative spillover effects triggered by corporate misconduct. In particular, we examine the improvements in the corporate social responsibility (CSR) of non-culpable portfolio firms in response to censorship of errant firms by a socially conscious institutional investor. We propose that ‘blacklisting’ or censoring firms from the portfolio due to their corporate misconduct is a form of institutional activism that delegitimizes the targeted firms. At the same time, blacklisting elicits attention from non-culpable firms (Ocasio, 1997), and increases the salience of CSR issues and the associated values espoused by the socially conscious investor audience. Consequently, we theorize that non-culpable firms respond preemptively and activate improvements in CSR to differentiate themselves from the culpable firms and hence, avoid becoming the target of socially conscious investors. By examining the question of non-culpable firms’ preemptive CSR strategies and the contingencies which either accentuate or dilute their CSR responses, we aim to connect the two separately evolving literatures on institutional activism and spillovers across firms that share membership within a category space.
We test our theory in the context of the Norwegian sovereign wealth fund (NSWF)—a socially responsible institutional investor—and the censorship of firms within its investment portfolio. Censorship is defined as the public divestment of a firm with the intent of ‘naming and shaming’ (Braithwaite, 1989) or delegitimizing in the eyes of other investors and stakeholders. More specifically, we examine whether censorship improves CSR more broadly among firms in the investor’s portfolio. Accordingly, our analysis examines the extent to which non-culpable firms respond to censorship by improving their CSR ratings on the various dimensions measured by their KLD indices. Following McWilliams & Siegel (2001:117) we define CSR as firm “actions that appear to further some social good, beyond the interests of the firm and that which is required by law.”

Findings from our empirical analysis reveal that censorship does indeed have a broader impact on non-culpable peer firms in the portfolio. By ‘making an example’ out of a limited number of firms, the NSWF has been able to induce a wider change in the CSR practices of non-culpable firms in its portfolio. We further find that both the level of ownership by the NSWF and the influence of other forms of institutional activism such as shareholder resolutions magnify the effect of censorship on non-culpable firms’ CSR. Importantly, firms within the NSWF portfolio show greater CSR improvements over non-portfolio firms, thereby strengthening our hypothesized causal effect of censorship. Contrary to the notion of stronger industry effects predicted by the theory of category membership, however, peer firms in the censored firms’ ‘dirty’ industries as do not improve their CSR significantly more than firms in other industries.

Our study makes both theoretical and empirical contributions to the growing literature on institutional activism and spillovers across firms within a category space. We shed light on the beneficial effect of censorship, variously referred to as negative screening or blacklisting, which
constitutes an understudied form of institutional activism, and is at times regarded as a questionable practice. As Colle & York (2009:89) argue “the exclusion of firms based on a priori criteria which identify them as the most socially harmful firms means that socially responsible investing cannot effectively achieve its goal of improving quality of life for all.” In contrast, our findings demonstrate the beneficial effects of censorship in terms of CSR outcomes and resonate with prior work (e.g. David et al., 2007) which has suggested that activists target individual firms to spur better corporate responsibility in a larger population of firms.

**THEORY AND HYPOTHESES**

Our baseline theory for non-culpable peer firms’ preemptive response to the delegitimizing effects of censorship requires us to establish three arguments pertaining to firm behavior. First, drawing from the attention-based view (Ocasio, 1997), firms pay increased attention to peers situated within the same category space following a delegitimizing event. Second, firms respond preemptively to deflect the threat of future delegitimization. Lastly, the type of response depends on a combination of factors namely issue salience and audience’s values. In our context, CSR represents such a response to censorship. Below we explicate each of these mechanisms that underpin our hypothesized relationships.

**Attention to censorship**

Firms sharing membership within any predefined category often conduct their daily operations without deliberate attention to their peers. Delegitimizing events, however, are highly salient instances that trigger greater managerial attention to firms’ category membership and to the circumstances of peers occupying the same category space. Using our Rana Plaza example highlighted earlier, following the crisis and subsequent public outcry, non-culpable apparel
companies were reminded that they fall into the category of ‘apparel companies that have international outsourcing operations. They also became attentive to the accusations by the public toward culpable firms and the garment industry in general, whilst anticipating the expectations of various audiences such as the media, policymakers and investors.

We suggest that potential negative spillover effects, often entail serious consequences such as reputational damage and negative assessment by investors, and therefore, motivate bystander or non-culpable firms to proactively mitigate such threats. From a strategic standpoint, non-culpable firms may be able to introduce firm level heterogeneity in terms of new observable information into audiences’ otherwise homogenizing categorization processes. In other words, proactive actions by non-culpable firms invoke differentiation-based competitive advantages that can alter audiences’ perceptions in a positive manner.

This forward-looking strategic behavior is particularly salient when circumstances are indicative of potential delegitimization from external audiences of that category space. For instance, Desai (2011) showed that firms within an industry actively engage in defensive institutional work activities, such as extensive public relations campaigns, to defend their field legitimacy following the occurrence of disruptive events. Likewise, examining the joint effects of social movements and shareholder activism, Reid & Toffel (2009) found that both targeted and non-targeted firms respond to shareholders’ appeals that are aligned with the demands of social movements on environmental issues. In their study of big-box retail firms, Yue et al. (2013) conceptualized protests as signals that spillover to a second mover of the same form as the target firm, and documented the conditions leading to organizational responses in terms of market entry. Even in settings where firms do not face the threat of delegitimacy, they pay attention to extra-jurisdictional regulatory pressures experienced by rivals and modify their
behaviors in anticipation of the environmental changes foreshadowed by those pressures (Fremeth & Shaver, 2014).

Activating CSR response by non-culpable firms

**Issue Salience.** A non-culpable firm could respond to delegitimizing events in a variety of ways depending on its issue-theorization of these events and on the anticipated expectation of its audience. Issue-theorization refers to an aspect of firms’ interpretive sense-making where a key issue is identified and an association is made as to how that issue relates to the firm’s context and audience. For instance, in cases of industrial accidents, the use of hazardous chemical inputs was identified to be the most salient issue of concern to the investor audiences (Diestre & Rajagopalan, 2014). Scandals related to financial misconducts such as deceptive accounting bring the broader issue of public sentiments towards corporate avarice into sharp relief (Paruchuri & Misangyi, 2014).

The discussion of how non-culpable firms respond is important to our theorizing because these firms often receive less information regarding the delegitimizing event compared to culpable firms. Moreover, they face greater difficulty in predicting audience’s categorization schemas (Jonsson et al, 2009) and organizational and accusation characteristics. For these reasons we depart from extant studies that have so far only featured firms’ responses that are highly issue specific e.g. financial misconduct, accidents and protests. For example, Reid and Toffel (2009) studied how non-targeted firms responded by disclosing their carbon footprint when other firms in the same field encountered shareholder resolutions on environmental issues. Instead, one of the novelties of our argument is that even when issues are not directly related, non-culpable firms could respond in a consistent but generic way. Applied to our context, although censorship announcements by the NSWF may be attributable to firms violating humans
rights, contributing to environmental degradation or simply operating in a controversial industry (e.g. tobacco), we contend that non-culpable portfolio firms tend to interpret such events as lapses in corporate responsibility more broadly. Because the delegitimizing signal always originates from the NSWF, over time the cumulative effect of successive exclusions leads firms to theorize beyond specific causes related to disparate events. Rather, the salient issue that is continually reinforced to non-culpable firms after each announcement is the need to conduct business in a socially responsible manner.

*Audience’s values*. The manner in which firms’ respond, however, is audience specific, such that firms are likely to respond in a manner that is consonant with the implicit or espoused values of the most probable audience related to the issue. An example clarifies our point. Yue et al. (2013) found that Target interpreted protests directed against Walmart’s entry into American communities and adjusted their own entry behavior accordingly. The salient issue identified was a general dissatisfaction towards discounter stores and the main audience that mattered to Target were local activists who represented the views of the community rather than national social movement organizations. Accordingly, Target refrained from entering localities that would increase their vulnerability. Such a response was consistent with the expectations and demands of its key audience—the local activists rather than national organizations. Relatedly, when the salient issue identified pertained specifically to Walmart, Target’s response was to discount the informational content in these protests and persist in its entry since it had greater confidence in securing acceptance within the community.

In the context of our research setting, the result of censorship by a large prominent investor such as the NSWF is twofold. First, in line with the diffusion-based argument (Soule, 1995), it serves as a meaningful signal and a guide to action for other socially conscious
institutional investors. Second, other institutional investors that share a common ‘cultural linkage’ (Strang & Meyer, 1993)—scrutinize firms’ CSR activities and demand socially responsible behavior—mobilize support from fellow activists and likewise inflict punitive actions against firms. Consistent with these ideas, Soule et al. (2014) found, for instance, that social activism targeted at multinational companies in their respective home countries diffused globally, leading to divestments from Burma.

Since the collective expectation of audiences, i.e. the NSWF and other similar socially conscious institutional investors is that firms in their portfolio behave in a responsible manner, the expected response of non-culpable peer firms is to signal their underlying qualities and commitment as a prosocial entity. By doing so, non-culpable firms in general reduce the risk of incurring unfavorable assessments, negative homogenizing judgments, and concomitantly the likelihood of being targeted by socially conscious institutional investors. In other words, such a proactive response provides firms with insurance-like benefits (Flammer, 2013; Jackson & Apostolakou, 2010).

One such strategic approach for non-culpable firms is to improve their CSR. There are two reasons supporting such a response. First, with the exception of large institutional investors who have the organizational resources to systematically conduct rigorous in-house assessments, most socially conscious institutional investors often rely on information intermediaries such as CSR rating agencies to efficiently monitor the social and environmental performance of their portfolio companies. Moreover, information intermediaries such as rating agencies often face pressures towards convergence in their assessments (Benner & Ranganathan, 2012). Therefore, to the extent that firms’ CSR practices are observed similarly by various information intermediaries, improving CSR represents a way for firms to influence the opinions of an
audience potentially broader than socially conscious institutional investors, and thus, deflect the threat of coordinated institutional activism (Neubaum and Zahra, 2006). Second, CSR practices encompass a degree of generality that allows firms to signal their legitimacy to various audiences. There are a number of dimensions on which firms can improve their CSR, thus giving them the flexibility to strategically choose CSR practices that build on their existing social competencies. For instance, some firms may already have a reputation of building effective and sustainable relationships with customers and suppliers while others have strengths in fostering a productive corporate culture that respects diversity. Still, other firms may have a history of positive interactions with local communities. Improving on these existing competencies would help firms economize on organizational resources compared to redesigning internal processes formulated specifically for an issue surrounding a single delegitimizing event. Therefore, we hypothesize that:

_Hypothesis 1: Censorship of firms by an institutional investor will contribute to enhanced CSR efforts by non-culpable firms within the investor’s portfolio._

**Factors moderating the effect of censorship on non-culpable firms CSR**

Having argued how non-culpable firms might respond to censorship, we now theorize about the mechanisms underpinning the effect of censorship in greater depth by turning to the surrounding factors which may moderate the effect of censorship. The extent to which non-culpable firms respond to censorship depends on their evaluation of issue salience and audience’s values. Firms that are more or less embedded within the portfolio through ownership ties with the investor or firms more closely associated with particular industries, therefore, may experience the effects of censorship differently. In addition to such contingencies related to industry and portfolio category representation, firms’ attention to the salient issues and audience’s values may be
altered depending on the strength of complementary voices from other institutional investors with similar demands.

**Category representation based on institutional ownership.** Stakeholder salience theory proposes that firms pay greater attention to institutional owners with larger holdings (Mitchell, Agle, & Wood, 1997). Much of the empirical literature on corporate governance has also established a positive relationship between institutional ownership size and firms’ CSR (e.g. Neubaum and Zahra, 2006; Johnson and Greening, 1999). The findings from this body of literature suggest that firms’ management tend to invest in better stakeholder management approaches when dealing with larger and longer-term institutional owners such as pension funds.

As a long term investor, the NSWF actively exercises its voting rights during shareholder meetings. Moreover, greater ownership in a firm allows it to increase its prominence and influence over other shareholders and their voting decisions. In fact, to retain credibility with the firm, the NSWF exercises prudence as it balances between signaling its preferences for socially responsible firm behavior and discerning unreasonable demands placed on firms’ management by other social activists. Consequently, firms identify more strongly as a member of the NSWF’s portfolio depending on the size of ownership, and also pay greater attention to censorship announcements by the NSWF in the expectation that such preferences would likewise be reflected in the NSWF’s voting behavior. Therefore we posit:

*H2: The effect of censorship on non-culpable firms’ CSR efforts is amplified in the presence of greater ownership by the institutional investor.*

**Category representation based on dirty industry.** Audiences often rely on simplifying cognitive categorization logics to generalize culpability from a particular delegitimizing event to other bystander firms that share key similarities with culpable firms (Diestre & Rajagopalan, 2014; Jonsson et al., 2009). Consequently, in the event of censorship announcements, one
category of firms that is more likely affected and hence, attentive to the issues and audience preferences surrounding the censorship would be its industry peers. Indeed, much of the literature on negative spillovers has used industry membership to identify a relevant population of firms that might be implicated (e.g. Jonsson et al., 2009; Paruchuri and Misyangi, 2014). Prior research has proffered the notion that disruptive events, such as scandals and crises, threaten the legitimacy of an industry and thereby spur a response from industry peers to preserve and repair their field legitimacy by engaging in extensive symbolic activities (Desai, 2011). We suggest that there are, however, subtle differences in how censorship affects industry peers.

Most of the issues surrounding existing censorships pertain to the contentious nature of firms’ line of businesses, which some scholars have termed ‘sin’ industries (Hillman & Keim, 2001). For instance, the NSWF has thus far divested firms for manufacturing cluster munitions, nuclear weapons, tobacco and notably, firms engaging in mining and forestry. Incidentally, these industries also experience high levels of stigmatization and scrutiny, defined as “ongoing, obtrusive and critical attention to particular organizational activities coming from customers, stockholders, board members, regulators, the press, and other members of the public” (Sutton & Galunic, 1996). Unlike disruptive events which require industry peers to challenge or allay audiences’ concerns associated with their industry’s underlying structural or operational problems such as poor safety records or ability to deal with hazardous chemicals, censorship on the basis of a firm’s membership in a ‘sin’ or ‘dirty’ industry raises firms’ attention to its social and environmental footprint as a whole and accentuates the relevance of its CSR.

Firms operating in these industries tend to be aware that their businesses are often viewed as socially undesirable and censorship announcements serve to reinforce or confirm audiences’ negative opinions. Unable to substantially change their business or exit the industry, which
would undermine their existence, firms’ likely recourse to censorship is to engage in more prosocial activities in order to offset audiences’ negative perceptions, i.e. “being bad but also doing more good” (Devinney, 2009). In this manner firms are able to engage in category manipulation (e.g. Porac, Wade, & Pollock, 1999), such that new information signaled by a non-culpable firm helps distance from the culpable firm and the salient issues surrounding censorship. Therefore, we hypothesize:

\[H3: \text{The effect of censorship on non-culpable firms’ CSR efforts is amplified when the non-culpable firms are in the same industry category as the censored firms (e.g. tobacco, nuclear arms).}\]

**Complementary shareholder activism.** Prior research on shareholder activism suggests that the use of shareholder proposals is increasingly adopted as a mainstream approach to direct managerial attention towards CSR issues (David et al., 2007; Reid & Toffel, 2009). This form of shareholder activism entails resolutions to be proposed and voted on by all shareholders during a firm’s annual general meeting, offering some shareholders a way to formally communicate their discontentment of firms’ CSR practices to shareholders as well as stakeholders, including customers and regulators. Although obtaining a majority vote remains a challenge and the desired changes are passed infrequently, activist shareholders often attain their broader objectives of targeting firms and elevating audience’s attention to firms’ deficiencies in CSR.

We argue that shareholder activism and censorship have a mutually reinforcing effect. Firms that have been targeted by shareholder proposals are already sensitized to demands for greater social responsibility, and are thus, likely to attend to censorship announcements with greater urgency. Moreover, censorship announcements serve as a confirmation of shareholder activists’ intentions and are indicative of increased shareholder pressure in the future, thereby leading to greater motivation for firms to undertake a preemptive CSR strategy. In addition, for
firms within the NSWF portfolio, a prior track record of being targeted by shareholder
resolutions may also increase their likelihood of being censored. Therefore we hypothesize:

\[ H4: \text{The effect of censorship on non-culpable firms’ CSR efforts will be amplified when}
\text{these firms are also targets of shareholder activism.} \]

**RESEARCH SETTING**

**Censorship by the Norwegian Sovereign Wealth Fund**

In our context, censorship by the NSWF is tantamount to a delegitimizing event as it contains the
detrimental effects of symbolic (reputational) and material damage (investor assessment in terms
of negative abnormal returns) (Dewenter, Han, & Malatesta, 2010). Established in 1998,
although the NSWF’s portfolio is benchmarked to the FTSEGlobal index, responsible
investments form the cornerstone of the Fund’s investment strategy (Backer, 2010; Chesterman,
2007). Towards this goal, the Fund periodically screens and censors firms in its portfolio that are
deemed to be involved with unethical and morally objectionable business practices that have
detrimental social consequences. Although the Fund comprises over 8000 firms of which thirty
percent are U.S. based, it has censored only about 60 firms globally, some of which are large and
prominent such as Walmart, Rio Tinto and Boeing. The decision to censor a firm is based on the
Fund’s independent assessment, often ahead of media reports, and relies on access to privileged
insider information. Indeed, the Fund’s policy documents reveal that censorship—which is
undertaken sparingly—is intended to serve as a means for promoting social change by way of
diffusing responsible behavior among firms and responsible investment norms among investors.

Adhering to a policy of transparency and public accountability, the NSWF’s exclusions
of firms from its investment portfolio are divestments that have the effect of publicly ‘naming
and shaming’ particular companies. Divestment is the final option in the Fund’s active ownership
strategy whereby intermediate, repeated dialogues with the firm’s top management have proven
to be ineffective and unsatisfactory in eliciting firm behaviors that reasonably meet the demands of the Fund. Given that the NSWF has a strong ethical mandate of incorporating social consciousness in its cross-border investments, censorship is a condemning value judgment by the Fund regarding the firm’s underlying quality—that it contains undesirable social and ethical attributes which are not rectifiable in the foreseeable future due to the firm’s recalcitrance.

While one may question whether the actions of a single investor (such as the NSWF) has the potency to affect changes in any firm which typically has multiple investors, we argue that the NSWF is an influential entity that is able to shape the opinions of other investors. The NSWF sees itself as a role model for other investors who similarly embrace principles of responsible investment regarding social and environmental issues. Such expectations are confirmed by the Graver committee, a task force set up in 2002 by the Norwegian government to establish the responsible investment principles for the NSWF, which reported that:

“[t]he [sovereign wealth] Fund can also play a role as a model for other funds or investors. The size of the Fund may induce many other investors to track the Fund’s activities closely. The decision whether and how to introduce ethical guidelines in the Fund may send an important signal and may cause other funds to follow suit.

The [sovereign wealth] Fund can also exert influence indirectly through the market. By explicitly communicating a decision not to buy a particular share, the Fund can send signals to company executives, other market participants and a company’s customers.” (Norwegian Ministry of Finance, 2003)

Within the realm of responsible investment, the NSWF and its Council of Ethics are widely regarded as a preeminent authority due to their thorough and professional assessment of firms’ responsible practices. As Paul Donowitz, EarthRights campaigns director stated: “…The Council on Ethics is known as the leading socially responsible investor in this world, so a finding by this body carries great weight with investors, analysts, and the public.” There is evidence that other large pension funds within Norway, such as KLP, as well as investors globally, such as New Zealand’s Superannuation Fund and the Swedish pension fund, are deferring to the
judgment of the NSWF ("Swedish Pension Funds Divest Freeport McMoRan Holdings," 2013). In addition, Vasudeva (2013) documented that the NSWF is able to exert its ideological influence through the diffusion of similar investment patterns among Norwegian firms, thereby leveraging market participants’ help in championing responsible investment practices. In sum, the NSWF does not act alone, so that disapproval by the NSWF could lead to similar assessments by other institutional investors.

When the decision to divest in a particular firm is reached, the Fund quietly begins to divest its shares in the culpable company in order to minimize speculative market reactions. However, once the divestment process is complete a press release, often involving major global news agencies, is held in which the Finance Minister of Norway articulates the rationale for exclusion and the position of the NSWF on issues related to the exclusion. In the case of Rio Tinto, a large global mining company that was excluded, the Norwegian Minister of Finance, Kristin Halvorsen, stated:

"Exclusion of a company from the Fund reflects our unwillingness to run an unacceptable risk of contributing to grossly unethical conduct. The Council on Ethics has concluded that Rio Tinto is directly involved, through its participation in the Grasberg mine in Indonesia, in the severe environmental damage caused by that mining operation. There are no indications to the effect that the company's practices will be changed in future. The Fund cannot hold ownership interests in such a company" (Council on Ethics, 2008).

In addition to press statements, supplementary documents detailing exchanges between the NSWF and the culpable firms are widely disseminated through the Ministry of Finance’s website, conferences and with market participants such as other socially conscious institutional investors. The provision of such valuable process information allows audience members to update their own judgments and reach similar conclusions regarding the justifiability of the NSWF’s actions. For example, the Council on Ethic’s report noted that:
“…the Council has contacted Rio Tinto through Norges Bank, requesting the company to comment on its participation in the mining operation and on the basis of the Council’s recommendation for exclusion… Rio Tinto’s response confirms the company’s investments and role in the Grasberg mine, but disputes the Council’s assessment that the mining operation causes severe environmental damage. The company regards the discharge as not being environmentally harmful, and the environmental damage as not being irreversible. However, the company fails to present new information that alters the Council’s perception of the environmental damage in this case.” (Council on Ethics, 2008).

To summarize, we have argued that censorship announcements by the NSWF are not only consequential but also independent of market or other external influence, and that it should warrant attention and motivate action by non-culpable portfolio firms. Yet, as the following comment from the NSWF’s Strategy Council aptly summarizes, little is known about the broader effects of censorship, and the positive social welfare outcomes if any. But even beyond social welfare benefits, as the meta analysis by Orlitzky, Schmidt and Rynes (2003) shows, the correlation effect size between CSR and financial performance is quite high at 0.18. Thus, CSR can improve portfolio firms’ financial performance which in turn can improve the extent to which an investor’s achieves its financial goals.

“The Strategy Council notes that little research has been conducted on the costs and benefits of divesting or excluding companies. There is also little research on whether divesting companies affect the portfolio of an investor. The report notes that a portfolio from which a large number of equities have been excluded may have a different return and risk profile than implied by the original investment strategy.¹”

DATA AND METHODOLOGY

Sample and research design

We identified portfolio firms from the annual reports of the NSWF (also known as the Government Pension Fund Global) which publishes records of its global equity holdings. Our hypotheses are tested using a sample that includes only U.S.-based portfolio firms in which the NSWF made equity investments in the period 1998-2011, with 1998 being the first year in which

¹ http://www.regjeringen.no/pages/38671176/translation1_2.pdf
the NSWF was established. We limit our study to U.S. based firms due to data coverage limitations for our dependent variable—CSR ratings obtained from KLD Research & Analytics, Inc. (KLD). The percentage of U.S. firms increased from 5% in 1998 to 20% of the NSWF’s portfolio. During the observation years in our sample, KLD reports CSR data for all U.S. based firms listed in the S&P 1500 index and Domini 400 Social Index that comprise mostly large and mid-sized companies. After combining the various datasets which we detail below, we arrived at a final sample including 1777 unique portfolio firms and an unbalanced panel of 8116 firm-year observations. In a supplementary analysis, we included U.S. based publicly-traded non-portfolio firms—in which the NSWF did not invest in the time period covered by our analysis.

**Dependent variable: Corporate social responsibility**

The main dependent variable, firms’ corporate social responsibility ratings, is measured by the environmental, social and governance ratings obtained from KLD, an independent third party social-rating agency. Compiled through various information sources including firms’ annual reports, annual surveys, business press and proxy statements, the KLD data profiles firms’ CSR by annually assessing their performance across a comprehensive set of CSR-related dimensions such as environment, human rights and corporate governance. Despite criticisms regarding subjectivity and lack of consideration for industry-wide effects (e.g. Chiu & Sharfman, 2011; Entine, 2003) as well as validity in predicting future CSR and financial performance (Chatterji, Levine & Toffel, 2009), KLD data has been widely used to measures of firms’ CSR ratings (Waddock & Graves, 1997; Deckop, Merriman, & Gupta, 2006; Doh, Howton, Howton, & Siegel, 2009; Sharkey & Bromley, 2014).

Despite these limitations, KLD ratings are appropriate for our analysis for three key reasons. First, in comparison to other more recently developed CSR metrics such as MSCI
Intangible Value Assessment or RiskMetrics Eco Value, KLD is one of the pioneer social raters that has a relatively long history of tracking firms since 1991. This time period encompasses our study period of 1998 to 2011. Second, KLD’s scoring system is fairly objective and transparent since raters use a predefined set of strengths and concerns issues pertinent to each category. For instance, under the environment category, KLD assigns a value of 1 to the strength issue of ‘presence of a pollution prevention program’, and 0 otherwise. Likewise, a concern would be assigned a value of 1 if the firm’s activity contributes to climate change, among other several indicators capturing environmental concerns. This contrasts with other known CSR metrics which use a seven-point rating scale and apply a weighting scheme that takes into account a firm’s risk in a particular environmental or social area—an endeavor which may be less transparent and more subject to biases. Third, while some scholars have argued that KLD scores ultimately capture firms’ CSR as perceived by a social rater rather than firms’ actual CSR (e.g. Entine, 2003), this distinction may not be a critical concern for our context. An increase in a firm’s KLD score attributable to censorship corresponds to greater response effort by the firm and consequently success in obtaining favorable perceptual assessments from information intermediaries such as social raters. KLD is used extensively by the socially conscious investor audience to complement their internal research and guide their investment decisions, making it a relevant data source for our study of institutional activism (Godfrey, 2011).

We obtained the net difference between aggregated strength and concerns scores, across the seven categories—corporate governance, environment, diversity, community relations, product quality, employee relations and human rights—that measure a firm’s CSR performance in a given year. Our choice of using net KLD score is consistent with our argument that CSR is a strategic response chosen by firms. Depending on their existing competencies, resource positions
and institutional environment, non-culpable firms could respond by enhancing their strength areas, reducing their areas of concern, or jointly doing both. Moreover, our use of net KLD scores follows from a well-established precedence in the CSR literature (e.g. Chin, Hambrick, & Treviño, 2013; David et al., 2007). The CSR scores for the firms in our sample ranged from -8.61 to 15.85 for firms in our sample.

Consistent with prior works on the effect of institutional ownership and activism on CSR (e.g. Neubaum and Zahra, 2006; David, Bloom and Hillman, 2007), we examine the lagged effect of censorships in year t on non-culpable firms’ net KLD score in year t+1. This lagged approach also helped us avoid simultaneity concerns. Finally, to adjust for industry effects we subtracted the industry average KLD score from this net score.

We acknowledge that CSR is a multidimensional construct and firms may perceive and respond to social and environmental issues in various ways. To address this concern, in a supplemental analysis, we group censorships separately by an issue area e.g. environmental degradation, involvement in munitions and violence, and investigate non-culpable firms’ response in the relevant CSR categories available in KLD.

**Independent variables**

Our main explanatory variable is the censorship of portfolio firms by the NSWF. We operationalized censorship based on the cumulative divested amount, rather than the counts of exclusions because the actual amount divested contains more informational value concerning the censorship’s severity. Although all censorships necessitate 100% divestment of a firm’s shares, an announcement of having sold 4.3billion (NOK) worth of shares in the case of Rio Tinto Ltd is not the same as that of having sold 318 million (NOK) worth of Textron Inc’s shares. The former censorship announcement sends a stronger signal to audiences in that the sheer magnitude is
likely to garner greater public attention compared to the latter. Moreover, non-culpable firms are likely to associate a larger divested amount with greater financial consequences for the censored firm. Such an effect would not be adequately captured if simple counts of censorship announcements were used.

Since censorships by the NSWF began in 2005, we include the cumulative divested amount for each year starting with 2005. As the divested amount increases over time it should capture the growing severity of censorship. To calculate this measure, we summed the divested market values and added this cumulatively to the prior year’s divested amount. Because divested firms’ market values were not available for the focal year of divestment, we used the previous year’s value from the NSWF annual reports. This yearly cumulated divested amount was then normalized by the cumulative number of firms excluded from the sovereign wealth fund’s investment universe. In a robustness check, we used yearly divested amounts rather than cumulative divestments to capture the immediacy of the censorships.

**Moderators**

*Institutional Ownership.* To test whether the effect of censorship is moderated by the NSWF’s ownership stake in its portfolio firms (H2), we used the percentage equity holdings by the NSWF as a measure of institutional ownership. Data on equity holdings was obtained from the Fund’s annual reports. The mean value of the Fund’s ownership in its portfolio firms is 0.38% of a firm’s market value.

*Dirty Industry.* To explore whether portfolio firms that are associated with socially undesirable industries respond differently to censorship (H3), we created a dummy variable, *Dirty Industry*, which equals 1 if firms operate in the same 4-digit NAICS industry as excluded firms and 0 otherwise. In addition, we manually checked whether the 4-digit classification
meaningfully and accurately reflects industries that are at risk of being perceived as socially undesirable. To that end, for certain industries such as mining, forestry and logging, we used the broader 3-digit classification code which we deemed to be more comprehensive, and likewise a more appropriate 5-digit classification code for other sub-industries. Results from our estimation remained qualitatively the same even when we applied a consistent 4 digit classification scheme. For instance, in 2009, the NSWF censored 17 tobacco manufacturers. Using a 5-digit classification code would accurately identify firms within the “Tobacco and Tobacco Product Merchant Wholesalers” industry instead of the 4-digit code that encompasses all firms in the “Miscellaneous Nondurable Goods Merchant Wholesalers” category. This coding scheme yielded 604 firms in our sample that belong to a Dirty Industry.

Shareholder activism. To measure the level of shareholder activism targeted against a portfolio firm (H4), we created a count variable of the total number of shareholder resolutions filed against a firm in a particular year by members of the Interfaith Centre on Corporate Responsibility (ICCR), a prominent shareholder organization whose core purpose is to support investor activism and whose members comprise faith-based and other socially conscious institutional investors. Data on shareholder resolutions, tracing back to 1991, were obtained from the EthVest dataset maintained by ICCR. (Reid & Toffel, 2009; Lee & Lounsbury, 2011; Lewis, Walls, & Dowell, 2014). Since the EthVest dataset only tracks firms which received shareholder resolutions, firms in our sample which did not match with the EthVest data were coded as having 0 resolutions filed against them. This approach is reasonable given that EthVest’s coverage include all U.S. publicly traded firms. Since we are concerned with the overall level of shareholder pressure faced by firms, we aggregated the resolutions across all issues: corporate
governance (15%), environment (22%), finance (3%), food (4%), health (13%), human rights (13%), inclusiveness (14%), lobbying (6%), militarism and violence (3%), sustainability (5%) and water (1%). Throughout our study period of 1998-2011, a total of 2876 resolutions were filed against firms in our sample. A maximum of 12 resolutions were passed against a firm in our sample.

Although, time series data regarding the NSWF’s voting behavior for each firm were not available, we expect that the voting behavior of the NSWF would substantially correspond to the overall level of shareholder activism against a firm. Thus, shareholder proposals raised through ICCR should capture the broad sentiments of the NSWF and other socially conscious investors.

Controls variables

Across all models, we included an array of firm level control variables which prior research has shown to associate with firms’ CSR ratings. Using financial data obtained from Standard and Poor’s (S&P) Compustat, we controlled for firm level characteristics that have been widely used in CSR research (Chin et al., 2013; David et al., 2007; Neubaum & Zahra, 2006): firm size, measured as sales (logged); liquidity (a proxy for slack resources), measured as the ratio of current assets to current liabilities; industry-adjusted profitability measured as return on assets i.e. the ratio of net income and total assets minus the average ROA for the industry; industry-adjusted market-to-book ratio (Tobin’s Q), measured as the ratio of market value of assets to book value of assets minus the industry average Tobin’s Q. Following prior CSR research (e.g.

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2 Numbers in parentheses indicate percentage breakdown of shareholder resolutions by issue.

3 Using the logged value of a firm’s total assets in our models yielded the same results.

4 Following Gompers et al. (2003), market asset value is calculated as the sum of book value of assets and the market value of common stock, net of the book value of common stock, preferred stock, deferred taxes and post-retirement benefits. This measure of Q is extensively used in existing literature (Fernando, Gatchev, & Spindt, 2012; Gompers, Ishii, & Metrick, 2003; Kaplan & Zingales, 1997) given its ease of calculation and availability for a large set of firms.
Chin et al., 2013; Matten & Moon, 2008), we included a measure of industry-average CSR calculated for all firms in the same 4-digit industry as the focal firm (excluding the focal firm).

In addition, we controlled for a firm’s degree of internationalization which could potentially influence its overall CSR practices as the firm responds to host country institutional pressures, such as anti-globalization movements arising from various stakeholders in different countries where it operates (Gjolberg, 2009). Firms operating in a global environment with increasing demands of social environmental responsibility may need to fulfill requirements beyond national rules and regulation to be perceived as legitimate and CSR may provide firms the necessary “social license to operate” (Sklair, 2001). Our internationalization variable was measured as the ratio of foreign assets to total assets. We aggregated firms’ non-domestic assets, in our case all non-US assets, obtained from the Compustat Historical Segments database.

Estimation

Since our dependent variable—CSR ratings—ranges from negative to positive values and is normally distributed, following prior work (David et al., 2007, Chin et al., 2013) we estimate our models using a fixed effects regression with clustered standard errors at the firm level. This estimation approach allows us to account for time-invariant firm-specific heterogeneity and reduces concerns of auto-correlation and heteroscedasticity (Greene, 2003). We also included year dummies to account for time trends in CSR.

Despite the strengths of this empirical strategy, we acknowledge that it does not fully meet the requirements for claiming a causal relationship between censorship and firms’ CSR outcomes. In our supplemental analyses, we test the robustness of our findings using a number of

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5 Using non industry-adjusted variables, namely CSR, profitability and Tobin’s Q yielded consistent results.
6 We also used foreign income ratio, measured as the ratio of foreign income to a firms’ total income as an alternative measure of internationalization. Results were consistent with either measure.
alternative specifications that address potential endogeneity concerns.

RESULTS

Descriptive statistics and simple bivariate correlations are provided in Table 1.

Table 2 reports the results of our hypotheses tests. Model 1 includes only the control variables. Model 2 tests our baseline hypothesis and reports the main effect of censorship on non-culpable firms’ CSR. Results from Model 2 show that after accounting for all relevant control variables, censorship is significantly positively associated with CSR ratings of non-culpable firms (p<0.01), providing support for Hypothesis 1 that the more severe the censorship, the greater the improvement in CSR of non-culpable firms. Specifically, for an annual average of 500 million USD worth of culpable firms’ shares divested coupled with public denouncement, non-culpable firms’ CSR increases by 1.6 points. This constitutes a significant improvement in CSR given that the mean value of CSR in our sample is 0.12.

Hypothesis 2 predicts that a higher level of ownership, i.e. stakeholder salience, by the NSWF in portfolio firms increases the potency of censorship, which would be supported by a positive interaction term. Model 3 tests this hypothesis and indicates a positive but only marginally significant interaction coefficient (p<0.1), thus providing weak support for Hypothesis 2. Figure 1 shows this interaction graphically.

Hypothesis 3 predicts that the effect of censorship would be amplified for non-culpable firms that belonged to the same industries as censored firms. Surprisingly, as Model 4 shows, the
interaction coefficient of censorship and Dirty industry was not significant (p= 0.662). Thus, Hypothesis 3 was not supported. We elaborate on this finding in the discussion section.

Hypothesis 4 predicts that shareholder activism would have a complementary effect on censorship, positively moderating the relationship between censorship and advances in non-culpable firms’ CSR. Results from Model 5 show a positive significant interaction between the number of resolutions and censorship (p<0.01), providing support for Hypothesis 4. Plotting this interaction effect in Figure 2\textsuperscript{7}, in which 52% of the observations lie within the region of significance, indicates strong support for Hypothesis 4.

[Insert Figure 2 Here]

Finally, Model 6 includes all main and interaction effects and yields support for the following hypotheses: censorships improve non-culpable firms’ CSR (H1); NSWF ownership holdings amplifies the effect of censorships on non-culpable firms’ CSR (H2); and shareholder activism amplifies the effect of censorships on non-culpable firms’ CSR (H4). We also estimated non-culpable firms’ CSR by separating their KLD strengths and concerns respectively. In this specification, we find strong consistent support for H1, H2 and H4 when the dependent variable is KLD strengths score. This suggests that non-culpable firms improve their CSR by increasing their prosocial activities rather than reducing their CSR concerns.

SUPPLEMENTAL ANALYSES

Alternative specifications

\textit{Matched sampling.} To establish that censorships cause the non-culpable firms’ improvements in CSR and to rule out alternative explanations that might arise from unobservable

\textsuperscript{7} Since 0 and 1 resolution comprise 96\% of our observations, we chose to plot the interaction effect based on these two meaningful points rather than the entire range of shareholder resolutions.
environmental conditions or firm characteristics we construct a matched sample of portfolio firms (treated group) and firms that are not in the NSWF’s portfolio (quasi-control group). Based on this matched sample, we employ a difference-in-difference estimator to compare CSR scores across both portfolio (treated) and non-portfolio (control) groups, before and after censorships began in 2005 using the values of censorship ranging from 0 to 599 million NOK.

To construct the matched sample, we used the coarsened exact matching procedure that matched each portfolio firm to another non-portfolio firm in the same 4-digit NAICS industry category with the most similar size (by sales logged), and shareholder activism (by number of resolutions). We exact matched based on industry because the likelihood of being affected by censorship which serves as proxy for the demands for enhanced CSR varies systematically by industry--i.e. firms within dirty industries may receive greater scrutiny from activist institutional investors such as the NSWF. We additionally matched based on size and level of shareholder activism because firms that are larger (or more prominent) and have a past record of being targeted by shareholder activism are more susceptible to public boycotts and protests (e.g. King, 2008), and forms of stakeholder pressures. By including these variables, our goal was to construct a control sample that was at a risk of being similarly affected by censorship as the portfolio firms, so as to minimize the chance that sampling bias explains the observed differences in CSR ratings between treatment and control firms. Our matching procedure ultimately yielded 2591 portfolio firms and 1564 matched non-portfolio firms. Our analysis was based on a total sample of 2551 firms.

We test the main effect of censorship using a difference-in-difference estimator—the coefficient of the interaction between the censorship variable and the Portfolio dummy variable—an indicator variable which equals 1 when a firm is within the NSWF’s portfolio and 0 if it is in
the control group. The difference-in-difference estimator captures the treatment effect of censorship by measuring whether CSR changes at a significantly different rate for portfolio firms compared to non-portfolio firms. Results from Model 9 in Table 3 below indicate a positive and significant coefficient for the difference estimator ($\beta = 0.003, p<0.01$) further supporting our main results. To aid us in interpreting our results, Figure 3 shows the line plots of CSR for the five-year period before 2005 based on our raw data and indicate that both portfolio and control firms were similar and comparable on average. After censorship began (represented by bar plots), non-portfolio firms experienced a continuous decline in CSR whereas portfolio firms improved their CSR over time. Figure 4 provides a graph for the estimated CSR performance for both portfolio (treated) and non-portfolio (control) firms for the periods before and after censorship began in 2005, and yields a pattern similar to the one reported in Figure 3.

Prior CSR rating. Following prior works using CSR as a dependent variable (e.g. Deckop et al., 2006; Flammer, 2014; Neubaum and Zahra, 2006), we temporally separated the dependent variable from the independent variables (using one and three year lags in different specifications), but did not control for prior levels of CSR performance in our main model. In an alternative specification, we test the robustness of our results by accounting for the impact of previous CSR performance on current or future CSR (i.e. a first order autoregressive process). It is possible that firms’ CSR is path dependent, such that firms experience a need to make CSR investments based on past commitments or prior CSR. We included a lagged dependent variable and allowed for the possibility that heteroscedasticity and autocorrelation may be present in our model. To address such issues, we employed the Arellano-Bond dynamic panel regression.
(Arellano & Bond, 1991) and included year dummies to reduce the bias associated with time-varying unobserved heterogeneity. This approach eliminates firm specific unobserved heterogeneity related to firms’ CSR by first-differencing or subtracting lagged values of regressors. By using lagged values of regressors as instruments of the first differenced regressors, the Arellano-Bond model also addresses the endogeneity concern that independent variables such as lagged values of CSR, censorship or shareholder activism are correlated with the error term. Results from this alternative model specification provided in Model 8 of Table 3 lend support to our main findings. Specifically, we find a positive and significant effect of censorship (β = 0.002, ρ<0.01) and the moderating effect of shareholder activism (β = 0.001, ρ<0.01). However, we did not find significant results for the moderating effects of the ownership and dirty industry variables. These results remained consistent whether we specified our independent variables as strictly exogenous or predetermined.

**Issue specific censorships and responses**

We performed separate analyses to address two additional questions concerning the robustness of our theory and findings. First, if non-culpable firms only paid attention to specific issues raised by censorships rather than to all censorship announcements in general, would our theory of firms responding proactively to censorship still hold? Since most firms have some form of environmental footprint (and thus hold the potential for damaging the environment), censorship announcements, such as those pertaining to environmental degradation will tend to be more germane to firms (and hence, more likely to elicit a response). In comparison, censorships related to nuclear weapons or cluster munitions are more industry specific and may apply to a smaller set of firms involved with weaponry. Second, if firms respond to specific issues, would the aggregated CSR ratings still remain a valid outcome? For instance, firms may be more likely to
improve CSR on their environment related dimensions compared to other CSR dimensions following censorships that pertain to environmental degradation. An increase in overall CSR in this case which is driven by improved corporate governance or employee relations rather than environmental CSR may not be directly attributable to the censorship.

To address such concerns we categorized all censorship announcements into issue areas based on the NSWF’s documented explanation for censoring each of the culpable firms. These areas include production of cluster/nuclear weapons (23)\(^8\), environmental degradation (11) investments in Western Sahara perpetuating territorial dispute (3), production of tobacco (21), violation of human and labor rights\(^9\) (5) and sale of weapons to Burma (1). We re-estimated our analyses using censorships related to the issue of environmental degradation that have direct applicability to most firms, and examined the effect on non-culpable firms’ responses in terms of environmental CSR. Further, we only used shareholder resolutions related to environmental issues as our moderator for shareholder activism. Results shown in Model 7 of Table 3\(^10\) are consistent with our main findings, although we do not find significant results for the moderating effects of ownership and membership in dirty industry. Overall, across all specifications, our robustness tests show strong support for our main hypothesis that censorships improve firms’ CSR, and the complementary effect of shareholder proposals.

\(^8\) Numbers in parentheses represent breakdown of censorship announcements by issues.
\(^9\) Although labor rights-related censorships could also be applicable to most firms’ labor practices, these censorships were present in our data only for 2006 in the case of Wal-Mart. Therefore we were unable to assess its impact on firms’ CSR given data limitations.
\(^10\) An alternative approach to understanding the role of issue specific censorships and responses would be to focus on the subset of non-culpable firms within the mining and forestry industry as these firms could conceivably be most concerned with censorships motivated by environmental degradation which is closely linked to their line of business. However the resulting sub-sample was too small for statistical results to be interpreted meaningfully.
DISCUSSION

A rich body of literature in the realm of institutional activism has shown that socially conscious investors employ governance strategies, such as shareholder proposals and divestments to elicit socially desirable behaviors from firms within their investment portfolio (e.g. David, Bloom, & Hillman, 2007; Johnson & Greening, 1999; Neubaum & Zahra, 2006; Proffitt, 2006). With few exceptions of field level studies (e.g. Reid & Toffel, 2009), less attention has been given to the question of how institutional activism leveled at certain targeted firms results in improved CSR behaviors of non-culpable firms in the portfolio. Our study takes a step in this direction; to understand whether institutional activism inspires a broader portfolio level change in CSR.

Our findings support the prediction that the practice of negative screening leading to censorship or blacklisting culpable firms can spur field level change and contribute to improvements in corporate conduct in CSR relevant domains. In this initial demonstration of the theoretical and practical significance of censorship, we examined its links to firms’ CSR efforts. We find that censorship has a main effect on non-culpable firms’ CSR efforts, which is amplified by ownership stakes of the NSWF. Our results also revealed that portfolio membership is a more relevant category space compared to industry membership.

While our study bears some semblance to Reid and Toffel (2009) who show that non-targeted firms respond to private politics, i.e. shareholder activism, our theoretical framework differ from theirs in two important ways. First, we show that instead of responding to specific issues, which in their case is non-targeted firms’ increased disclosure of their carbon footprint following shareholder activism, non-culpable firms in our study responded to the generic issue of socially responsible business conduct by enhancing their CSR efforts. Our findings thus, hold significance for audiences such as socially conscious investors who are typically concerned with
firms’ overall CSR rather than their willingness to respond to specific issues by way of greater information disclosure.

Second we incorporate the effects of two different modes of institutional activism—censorship and shareholder proposals—and theorize about how one may impact the other. By demonstrating that the effect of censorship is amplified when firms are also targeted by shareholder activism, our study examines the interdependence of voice (or shareholder proposals and engagement with management) and exit (or censorship) in achieving the desired CSR practices. To our knowledge, our study is the first to examine the complementarity between these two qualitatively different modes of institutional activism. On one hand, we feature a prominent, large institutional investor acting independently of others in diffusing its social, environmental and ethical ideology through the use of censorships. On the other, we document shareholder activism by a collective of smaller socially conscious investors acting through the Interfaith Council on Corporate Responsibility. Interestingly, we do not find a significant main effect for shareholder activism variable in Model 2, which suggests that shareholder activism through proposals by itself may not be sufficient for non-culpable firms to respond, thereby providing evidence that runs counter to Reid and Toffel (2009). This finding is also consistent with our current state of knowledge on shareholder activism that its efficacy for firms’ CSR is at best equivocal (David et al., 2007).

Our findings also depart from the conventional wisdom which holds that since small investors tend to free-ride on the efforts of large investors, such behavior reduces the incentive for large investors to exert governance oversight. While smaller social activists and investors may benefit from the efforts of the NSWF, our positive significant findings for the interaction
between shareholder activism and censorships suggest that censorships may also benefit from the effect of shareholder proposals.

We did not find support for the effect of membership within ‘dirty’ industries. In other words, firms within ‘dirty’ industries do not improve their CSR significantly more than other firms. This finding runs counter to the preponderance of works in the categorization literature that has documented that public (or audience) opinions diffuse quickly beyond organizational characteristics and boundaries to the industry level following a negative event befalling a particular firm. It is possible that firms in ‘dirty’ industries recognize that since the issue propagated from censorships concern their line of business, a fact which cannot be changed, there are no clear benefits in responding to censorships. Portfolio firms in ‘dirty’ industries in particular may realize it would be a matter of time before they are targeted. For instance, since 2005, the NSWF has been steadily excluding firms involved in producing cluster munitions and its associated components while qualifying publicly that the list of firms censored thus far is not exhaustive and that future censorships of similar firms is possible. Moreover, based on a search of news articles surrounding firms that were censored, we found anecdotal evidence that more than 50% of the censored firms do not respond publicly, but rather accept the Fund’s decisions or refuse to comment. Given limited recourse, the choice of remaining silent and passive may help avoid unwanted attention towards firms in the industry. It is also possible that firms in ‘dirty’ industries do not respond at a significantly higher rate because they consistently experience higher levels of media coverage—some of which may be positive highlighting their charitable donations and prosocial activities—such that they become immune to the negative signals (King and Soule, 2007) emanating from censorship announcements. Although it is beyond the scope of our work to consider the role of media at length, we have highlighted earlier that censorships are
made public and transparent and thus, we surmise that media attention could reasonably be assumed to remain constant for censorships. One future extension may be to consider the role of media attention, targeted at firms and in the coverage of censorship announcements, in influencing the strength firms’ CSR responses.

Our study also suggests that the effect of censorships is not necessarily confined within national boundaries. In our study, only about one third of censorship announcements pertain to U.S. firms. In a supplementary analysis, we removed censorships targeted at U.S firms and re-estimated our analyses. Our results remained consistent. Thus, in addition to influencing home country firms (Vasudeva, 2013), our findings show that the NSWF is able to exert a normative pressure on firms globally. Furthermore, by showing that improvements in CSR is one potential outcome driven by censorship, we contribute to the growing evidence that activist investors promotes good corporate governance practices around the world (Aggarwal et al., 2011). A recent article in the Economist (2015: 24) similarly lauds activist investors as “capitalism’s unlikely heroes”, and notes that “activist interventions, lead to a sustained, if modest, improvement in operating performance and shareholder returns.” Future work could test the robustness of our findings on firms in a multi-country study design to identify important national characteristics that could moderate the effectiveness of censorship.

From a policy standpoint, our study suggests that despite criticisms, censorship is a feasible governance strategy that prominent institutional investors can leverage to bring about broader improvements in firms’ CSR within their portfolio. By making an example out of a small number of firms, the threat of censorship may elicit improved corporate behavior whilst at the same time galvanize attention from other socially conscious investors toward similar issues. Censorship also introduces nuance to investors ‘voting with their feet’ i.e. via divestments.
Current prescriptions strongly privilege shareholder proposal activism and close engagement with firms’ management compared to divestments, since the latter indicates a refusal to partake in improving firms’ behavior, while also limiting the universe of financially viable investments. Our study shows that such a notion should be revisited. Sparing usage of divestments in a manner akin to censorships may instead yield favorable results for socially conscious investors, especially in combination with shareholder proposal activism.

**Limitations and Future Directions**

As with any empirical endeavor, our study has limitations which suggest opportunities for refinements and extensions. Our mechanism of censorships affecting non-culpable firms’ CSR is conditional on firm paying attention to censorship announcements. While we do not test this mechanism directly in our current study, we have gone at lengths to demonstrate its effects via various contingencies incorporated in our model as well as supplementary analysis. Future work could test this mechanism directly by leveraging a survey research design for a smaller subset of portfolio and non-portfolio firms.

Although this study considered the beneficial aspects of investor activism via censorship, it does not consider the possibility that the legitimacy of censorship announcements themselves may be challenged by other social investors and firms could incorporate such information within their response. Just as tactics within social movements may at times be at odds with one another, social activists may not support certain censorship decisions. For instance, Mark Anson, a former CIO of CalPERS asserted that “it is hard to do well by doing good when you shrink your opportunity set.” Similarly, the United Nations Principles for Responsible Investment (UNPRI) advocates a more contemporary positive screening methodology that seeks to identify companies with good environmental, social and governance practices. Conversely, some analysts and non-
governmental organizations (NGOs) have expressed their disapproval of the NSWF’s decision to not divest from PetroChina’s oil and gas pipeline in Myanmar. A representative of the Shwe Gas Movement, a Myanmese NGO commented, “As the second-largest sovereign wealth fund in the world, Norway's government pension fund is in a powerful position to promote responsible investment in Burma. It is shameful that the Norwegian government is endorsing human rights abusers in Burma through the investments of its pension fund.” Further, EarthRights International, an NGO based in the U.S. and Southeast Asia described the Norwegian Ministry of Finance’s decision as a “troubling setback for socially responsible investing.” To the extent that such diversity in opinions exist, our findings are conservative since even in the presence of some dissenting views from audience members, non-culpable firms still improve their CSR efforts. It would be interesting to investigate if contradicting logics reflected in messages from socially conscious audiences could result in firms discounting some allegations while privileging others.

In sum, our paper connects two different strands of literature. The first pertains to the literature on spillover effects across firms within a category space. This literature has been largely concerned with firm implications of severe negative events such as accidents, crises, corporate frauds etc. Most work in this domain with the exception of Desai (2011) has yet to document how non-culpable firms may respond to such delegitimizing events. The second strand of literature deals with the phenomenon of institutional activism. While studies have established that institutional activism leveled at specific firms can spur improvements in firms’ CSR, the question of whether institutional activism could have broader social welfare benefits remains relatively unexplored. By studying the NSWF’s censorship and its beneficial effect on non-culpable firms’ CSR, we take a first step to unite two bodies of knowledge concerning institutional activism and spillover effects that should be in conversation with one another.
 References


Figure 1. The interaction of censorship and ownership on non-culpable firms' CSR*

*All other predictors held at mean values.

Figure 2. The interaction of censorship and shareholder activism on non-culpable firms' CSR*

*All other predictors held at mean values.
Figure 3. Observed CSR of treated and matched firms before and after censorships based on raw data.

* Numbers above bar plots indicate the number of censorship announcements in that year

Figure 4. Estimated CSR of treated and matched firms before and after censorships based on diff-in-diff estimates.
Table 1. Correlations and Descriptive Statistics*

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<th>S.D.</th>
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<th>3</th>
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<th>8</th>
<th>9</th>
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<td>9 Liquidity</td>
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<td>2.131</td>
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<td>51.496</td>
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*p < 0.05 for correlations in bold
Table 1. Firm Fixed Effects Analysis of Effects of Censorship on non-culpable firms' CSR

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<th>VARIABLES</th>
<th>Model 1</th>
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<th>Model 3</th>
<th>Model 4</th>
<th>Model 5</th>
<th>Model 6</th>
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<td>-0.205***</td>
<td>-0.205***</td>
<td>-0.205***</td>
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<td>(0.044)</td>
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<tr>
<td>Industry-adjusted profitability</td>
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<td>-0.218**</td>
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<td>Liquidity (current asssets / current liabilities)</td>
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<td>-0.086</td>
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<td>-0.069</td>
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<td>-0.402***</td>
<td>-0.402***</td>
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<td>YES</td>
<td>YES</td>
<td>YES</td>
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<td>(0.001)</td>
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<tr>
<td>Censorship x Shareholder Activism (H4)</td>
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<td>0.001***</td>
<td>0.001***</td>
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Clumped standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1
Table 2. Comparison of alternative specifications and estimations of the effects of censorship on non-culpable firms' CSR

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<th>VARIABLES</th>
<th>Model 6</th>
<th>Model 7 (Environmental)</th>
<th>Model 8 (Arellano Bond)</th>
<th>Model 9 (Diff-in-Diff)</th>
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<tr>
<td>Industry average CSR</td>
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<td>Industry-adjusted profitability</td>
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<td>Size (sales logged)</td>
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<td>(0.097)</td>
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<td>(0.066)</td>
<td>(0.069)</td>
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<td>Liquidity (current assets / current liabilities)</td>
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<td>0.013**</td>
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<td>Censorship (H1)</td>
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<td>0.002***</td>
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<td>Ownership</td>
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<td>YES</td>
<td>YES</td>
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<tr>
<td>Censorship x Shareholder Activism (H4)</td>
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<tr>
<td>Censorship x Portfolio</td>
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<td>0.003***</td>
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</tr>
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<td>R-squared</td>
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Clustered standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

1: Censorship and Shareholder activism variables are specific to environmental issues