Motivation

How do (perceived) unethical firms fall out of favour with investors and become undervalued? I examine the impact of ethical exclusions.

Setting

The Norwegian Sovereign Wealth Fund, GPFG

Overview of Exclusions

Exclusions by Type

Regional Composition

Hypotheses

1. Exclusions reduce firm investor base and cause a demand driven downward shock to returns - no returns reversal, investor divesting behaviour
2. Investor overreaction with a short term sell-off and later purchases - return reversal
3. Ethics sensitive investors replaced by ethics insensitive investors - return reversal and investor base switch

Financial Impact of Exclusions

Standard event study statistics are used, from Campbell et al. (1997), (Ch. 4) and Kolari & Pynnonen (2010) (J1, J2, and J3) as well as the Dewenter et al. (2010) Z-score statistic. CARs are Cumulative Abnormal Returns, which is the difference between expected and observed returns.

Summary of results

• Negative impact of the exclusions, which is not reversed in the short term
• CARs are more pronounced and statistically significant for product relative to conduct exclusions
• However this disparity is no longer statistically significant after accounting for firm characteristics in a regression setting (Size, M/B, age, turnover, past returns, region)

All exclusions

Thick line if J2 is significant at 10%

Mean CARs

Ownership by Ethics Sensitive Investors

I compute how many funds own shares in excluded firms on average in each event time quarter.

Responsible Mutual Fund (MF) Ownership, US-listed Funds and Firms

• An excluded firm is held by fewer Ethical MFs in the quarter following exclusions
• Mean ownership levels fall from 1.15 funds to 1.02 funds for the total sample
• The effect is due to fund reactions to product exclusions

Pension Fund (PF) Ownership

• Pension funds show large geographical heterogeneity in responses, I demonstrate the results for coal exclusions:
  - European PFs react in the short term but have already began reducing ownership
  - US PFs show larger and longer lasting effects

Hypotheses

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Takeaways

• There is a negative impact of the exclusions which is not reversed in the short term
• Moderate clientele change, driven by ethics sensitive investors selling out of product exclusions, provides further evidence for the demand driven mechanism

Summary

• I document how firms fall out of favour with investors and become undervalued
• The results suggest that ethical exclusion announcements have an impact on equity value, which is partially due to divestment behaviour by ethics sensitive investors

Corporate Ethical Behaviours and Firm Equity Value and Ownership

Evidence from the GPFG’s ethical exclusions

Vaska Atta-Darkua

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