

MANAGERIAL ENTRENCHMENT AND CORPORATE SOCIAL PERFORMANCE [†]

JORDI SURROCA

Universidad Carlos III de Madrid
Department of Business Administration
Calle Madrid, 126
Getafe (Madrid), Spain, 28903
Phone: (34) 91-624-8640
Fax: (34) 91-624-9607
e-mail: jsurroca@emp.uc3m.es

JOSEP A. TRIBÓ *

Universidad Carlos III de Madrid
Department of Business Administration
Calle Madrid, 126
Getafe (Madrid), Spain, 28903
Phone: (34) 91-624-9321
Fax: (34) 91-624-9607
e-mail: joatribo@emp.uc3m.es

* Corresponding author

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Abstract

We examine empirically the relationships amongst managerial entrenchment practices, social performance, and financial performance. We hypothesize that entrenched managers may collude with non-shareholder stakeholders in order to reinforce their entrenchment strategy; this is particularly so in firms that have efficient internal control mechanisms. Moreover, we prove that the combination of entrenchment strategies and the implementation of socially responsible actions have particularly negative effects on financial performance. We demonstrate our theoretical contention using different proxies of entrenchment like the existence of antitakeover initiatives or the manipulations of earnings from a database comprising 777 companies from 28 countries in the period 2002-2005.

EFMA Classification: 150, 110, 180.

Keywords: Corporate Governance, Stakeholder Activism, Corporate Social Performance, Earnings Management.

1/ INTRODUCTION

Agency theory has contributed to spread the long held view that decisions taken by managers often go against the interests of the organizations they are managing. In an agency contract, the principal, investors or outsiders, transfers certain duties to the agent; a manager, an entrepreneur or an insider. Given that they often face a situation of limited rationality and imperfect information, the contract does not instruct the agent adequately, on how to act when faced with circumstances that could not have been foreseen. Such circumstances are common in the normal running of a business. Contracts are, therefore, incomplete and, in an information asymmetric context, give the agent the power of pursuing their own benefit against the interests of the principal. Managers may: exert insufficient effort; find it convenient to accept overstaffing; amass private benefits by building empires, enjoying perquisite consumption, or even by stealing from the firm (Shleifer and Vishny, 1997).

One of the costliest manifestations of the agency problem is managerial entrenchment (Jensen and Ruback, 1983). Managers, who place a great value on control but own only a small equity stake, work to ensure their own job security thereby entrenching themselves and staying on in that position even if no longer competent or qualified to run the firm (Shleifer and Vishny, 1989). Walsh and Seward (1990) discussed different classes of managerial entrenchment practices to neutralize the disciplinary mechanism of a market for corporate control. Dual-class recapitalization, poison pills, supermajority amendments, anti-takeover amendments, and golden parachutes, are examples of such practices. Additionally, managers may resort to earnings manipulation as a way of improving their job security (Fudenberg and Tirole, 1995). This idea is supported empirically by Yeo *et al.* (2002).

Although the presence of anti-takeover defenses may serve to decrease the efficiency of external control mechanisms to the point where the cost of a takeover is prohibitive, we cannot assume that entrenched managers will be perfectly hedged against the actions of shareholders. This is so because of strong internal corporate governance mechanisms like the proportion of independent directors on the board composition, reduce the need for the operation of the takeover market (Sundaramurthy *et al.*, 1997). In fact, Sundaramurthy *et al.*, (1997) shows that the negative market reaction to takeover defenses adopted by entrenched managers is contingent on board configuration: the larger the proportion of independent directors, the lower the negative market reaction after the implementation of anti-takeover measures. Sundaramurthy's (2000) relies on this contingency model to explain the consequences of anti-takeover

provisions on shareholders' wealth. In such a model, both board structure and shareholder monitoring moderate the relationship between anti-takeover provisions and shareholder interests. In addition, Vafeas (1999) expects other internal governance mechanisms to be effective disciplinary arrangements, in order to resolve agency problems such as the existence of different board subcommittees.

Then if the capital market recognizes internal control structures such as the board of directors, ownership structures, and board subcommittees, as a substitute for the monitoring effects of the takeover market, we expect that entrenched managers in such a situations will anticipate this internal battle for control and, therefore, may engage in other types of entrenchment practices so as to block these governance mechanisms.

In this paper, we hypothesize that entrenched managers may collude with non-shareholder stakeholders – i.e., employees, communities, customers, and suppliers – to protect themselves from internal disciplining mechanisms, causing a subsequent reduction in shareholders' wealth. We rely on two arguments to justify the manager's commitment to follow stakeholder-friendly behavior. Firstly, by colluding with stakeholders, the manager reduces a firm's attractiveness to potential raiders, because generous long-term stakeholders' concessions hinder the raider's ability to generate profit (Pagano and Volpin, 2005). And secondly, stakeholders generally accumulate certain powers to promote or disgrace top executives (DeAngelo and DeAngelo, 1998; Hellwig, 2000; Rowley and Berman, 2000); they may engage in costly boycotts and media campaigns (Baron, 2001; Feddersen and Gilligan, 2001; John and Klein, 2003) or stakeholder representatives may be present in corporate boards (Luoma and Goodstein, 1999; Schnepfer and Guillén, 2004). Moreover, due to the fact that the manager retains the confidence of stakeholders, it will be more costly for displeased shareholders to remove him because they will have to face pressure from the non-shareholder stakeholders.

In order to gain support from stakeholders, entrenched managers engage in a broad array of practices to deal with and create relationships with corporate stakeholders and the natural environment; the so-called corporate social performance or CSP (Waddock, 2004). Therefore, this study specifically tests the hypothesis that managerial entrenchment practices are positively related to improvements in CSP which, in turn, negatively affect firms' financial performance. Moreover, we expect this relationship will be stronger in those firms where there are well-developed internal corporate governance mechanisms for controlling a manager such as those where there is a large

proportion of independent directors in the board and/or the CEO and the chairman do not coincide in the same person and/or there are independent committees for deciding on remunerations and promotions. In such situations, the manager has more difficulties in triggering entrenchment strategies based on confrontation with shareholders like the aforementioned poison pills and/or the limitation of shareholders' rights rather than strategies relying on cooperation with non-shareholders stakeholders.

To demonstrate our theoretical contention, we make use of an international database provided by the Sustainable Investment Research International (SiRi) Company, an international network of social research organizations that scrutinizes firms with respect to their practices toward employees, communities, suppliers, customers, environment, and shareholders. These data include and expand upon those of Kinder, Lyndenberg, Domini, and Company (KLD) which has been used in several papers studying stakeholders' issues (Agle et al., 1999; Berman et al., 1999; Hillman and Keim, 2001; Waddock and Graves, 1997). Our final sample comprises 717 firms from 28 nations; hence, we can argue that it is representative of different institutional frameworks. This is a relevant point, because the institutional environment clearly shapes the relationship between a firm's corporate governance structure and stakeholder interests (Aguilera and Jackson, 2003; Schnepfer and Guillén, 2004).

Our study has antecedents in and contributes to both the agency and stakeholder theories. First, our study is one of the few to investigate the association between corporate governance mechanisms and stakeholder concessions. Previous literature on this issue has analyzed relationships between CSP and CEO's incentives (McGuire et al., 2003; Coombs and Gilley, 2005), board composition and environmental performance (Kassinis and Vafeas, 2002, 2006); frequency of takeovers and stakeholders' rights (Schnepfer and Guillén, 2004); and the influence of institutional investor type, managerial equity, and independence of boards on CSP (Johnson and Greening, 1999). Our article goes a step further and examines the connections among entrenchment practices (i.e., anti-takeover devices, limitation of shareholders' rights, earnings manipulation), internal corporate governance mechanisms (i.e., board independence, the presence of board subcommittees, and ownership concentration), CSP, and corporate financial performance. Second, this study advances the understanding of stakeholder phenomena by providing another explanation of CSP: the entrenchment hypothesis. Previous literature on stakeholder theory has provided normative, instrumental and descriptive/empirical explanations of CSP (Donaldson and Preston, 1995). Our entrenchment argument for improving CSP falls into the

instrumental strand and develops the descriptive approach (Mitchell et al., 1997; Jawahar and McLaughlin, 2001), which suggests that the degree to which managers give priority to competing stakeholders' claims – the salience – is positively related to the stakeholder attributes of power, legitimacy, and urgency. In our case, we add to Mitchell and colleagues' (1997) model the idea that, not only is the CEO's perception of the aforementioned attributes important to explain stakeholder salience, but also to managerial strategic actions such as entrenchment practices. This study also extends agency theory from a stakeholder perspective, by examining the role employees, communities, customers, and suppliers, may play in exacerbating or ameliorating conflicts of interests between managers and shareholders. In doing so, we expand the game-theoretical model of Pagano and Volpin (2005) to include not only workers but other stakeholders, and subsequently, we test empirically its main propositions. Finally, in this study we provide a further evidence of the entrenchment motives that may explain certain practices of earnings manipulations (Yeo et al, 2002) as well as their connection with CSP (Cespa and Cestone, 2004). Managers manipulate earnings and pursue their own interests while simultaneously satisfying the short-term interests of shareholders, thereby damaging their medium-term interests. This reinforces the short-term position of managers (related to entrenchment) while weakening their medium-term one. Then, in order to eliminate the medium-term risk of being dismissed, managers will require the connivance of non-shareholder stakeholders. Then, managers will satisfy non-shareholder stakeholders interests by improving a firm's CSP. Hence, independently of the entrenchment mechanism used (poison pills, limitation of shareholder rights or earnings manipulation), our basic claim is that entrenchment practices lead to improvements in a firm's CSP.

The rest of the article is structured as follows. Section 2 summarizes the most relevant literature akin to the objectives of this work. In Section 3 we develop the hypotheses. Section 4 is methodological and describes the sample, variables and empirical models to be tested. The empirical results obtained are presented in Section 5, while some extensions are addressed in Section 6. In the final section of the article, we lay out the main conclusions of this research and discuss the significance of our results.

2/ REVIEW OF THE LITERATURE

Managerial entrenchment

Traditionally, agency theory has dominated the analysis of corporate governance. Its main concern is the separation of ownership and control, and the possibility that managers (agents) take actions that hurt shareholders – principals – (Eisenhardt, 1989). Managers may amass private benefits by building empires, maintain costly labor, pay inflated transfer prices to affiliated entities, or simply exert insufficient effort. The genesis of this agency problem is twofold: first, the dispersion of ownership and, second, the reduced proportion of equity that managers hold in the firm (Jensen and Meckling, 1976). Ownership dispersion generates free-riding problems in monitoring and controlling the behavior of managers, while low managerial equity holdings imply that managers enjoy the private benefits of control and only bear a fraction of its costs. As a consequence of both forces, managers may deploy corporate assets to obtain personal benefits like perquisite consumption.

In this context, a good governance structure is then one that is able to align the interests of principals and agents. Shleifer and Vishny (1997) discussed the available mechanisms to force agents to internalize the welfare of shareholders that are classified according to their internal or external nature. Internal mechanisms are managerial incentives like stock-options and other forms of performance-based payment schemes, and control structures such as the presence of institutional blockholders, the presence of outsiders in the board of directors, or the existence of audit/remuneration/nomination committees. On the other hand, the market for corporate control, product market competition or managerial labor markets are examples of external mechanisms of corporate governance.

The need for governance mechanisms seems to be lower as the managerial stake increases; agency costs become lower since managers bear a larger share of these costs (Jensen and Meckling, 1976). Some researchers argue, however, that increasing managerial ownership may not increase shareholder wealth, as managers could increase their ownership to a degree that would allow them to dominate the board of directors, thereby becoming insulated from internal or external corporate governance mechanisms such as hostile takeovers (Fama and Jensen, 1983).

The situation is different when the managers' stake is low. In such a case, the takeover threat may be a powerful mechanism to discipline managerial behavior because managers know that they are at risk of being dismissed for sub-optimal corporate performance (even if they did not contribute to these bad results). Anticipating this possibility, managers may adopt several forms of entrenchment practices (Walsh and Seward, 1990). Among them is the issue of common stock, with limited voting rights, which is then exchanged for a certain number of old common shares; the repurchase of large blocks of shares from potential acquirers without the approval of shareholders; poison pills; new security issues; specific acquisitions and divestitures; supermajority amendments; golden parachutes; and earnings manipulation. Each of these practices may reduce the efficacy of corporate governance mechanisms to the point that the cost of a takeover exceeds its potential benefits. Moreover, the implementation of these measures is not only costly on their own but also, once the manager is immune to the threat of takeovers, he can pursue his own interests at the expense of shareholders' best interests, which is reflected in lower share prices (Shleifer and Vishny, 1989).

Different governance structures that may amplify or mitigate the consequences of entrenchment emerge within this setting (Walsh and Seward, 1990; Sundaramurthy et al., 1997; Sundaramurthy, 2000): 1) the composition of boards of directors; 2) the concentration of ownership; 3) the existence of different board subcommittees.

On the composition of the boards, we can argue that boards with a majority of outside non-executive directors have all the incentive to oppose managers' entrenchment actions (Fama and Jensen, 1983). However, this control will be diminished if the chief executive officer (CEO) is also the chairman of the board. This dual role of CEO can give rise to a conflict of interest preventing boards from being effective in their monitoring and supervision tasks.

The second mechanism relates to the ownership structure. In more concentrated ownership structures, large investors have the incentive to collect information and monitor the management, thereby reducing managerial agency costs and preventing entrenchment (Shleifer and Vishny, 1986). However, a second problem emerges as large shareholders pursue their own interests and may expropriate minority shareholders (Shleifer and Vishny, 1997). In fact, they may even collude with managers, by allowing certain entrenchment strategies, in order to expropriate minority shareholders (Pound, 1988). Remarkably, when control is dissipated among several large investors, a decision to expropriate minority shareholders requires the consent of a coalition of investors –

controlling coalition- a situation which dilutes the power, protects the minority and prevents entrenchment collusion with the manager; this influences corporate performance positively (Bennedsen and Wolfenzon, 2000).

Finally, a firm can mitigate the problem of agency by setting up independent committees. The Securities and Exchange Commission (SEC) considers committees as important tools to monitor corporate activities; it requires all of its registered companies to disclose whether or not they have an audit committee, a compensation committee or a nominating committee. Past evidence supported the idea that the existence and composition of these committees are positively related to effective decision-making (Vafeas, 1999; Anderson and Reeb, 2004). However, committees under the influence of top management, such as those composed in the majority by insiders, are more likely to harm minority shareholder interests (Vafeas, 1999).

In summary, this analysis suggests that organizations may suffer from managerial misbehavior and that several strong governance structures can hinder managers from extracting private benefits by implementing entrenchment strategies (Combs and Skill, 2003). In the next section, we propose stakeholder activism as another control mechanism to monitor and control managers.

Stakeholder activism

Manager's decision can have a direct impact on all stakeholder groups and, consequently, the manager can be viewed as the stakeholders' agent, and not just the shareholders' agent (Hill and Jones, 1992; Jones, 1995). Therefore, a firm is not conceived as a bilateral relationship between shareholders and managers but as a multilateral set of relationships amongst stakeholders (Aguilera and Jackson, 2003). Each stakeholder has, in turn, their own interests, which generally are in conflict with other stakeholders'. Certainly, one of the most important conflicts of interest is between managers and all other stakeholders; this defines an amplified agency problem (Hill and Jones, 1992). This divergence of interests is problematic because it prevents stakeholders from maximizing their utility and may lead to the emergence of power differentials among stakeholders. Moreover, managers may use such differentials to further entrench their position and modify the firm's institutional structures to their advantage (Hill and Jones, 1992). In this context, stakeholders articulate different responses to restrict management power.

A primary response may be to reward or punish management's actions as a means of influencing their behavior (Rowley and Berman, 2000). Boycotts and

lobbying are some examples of these actions (Baron, 2001; Feddersen and Gilligan, 2001; John and Klein, 2003). By wielding the threat of having to endure costly boycotts and media campaigns, stakeholders exert a substantial controlling influence over firms.

Another channel of influence is via the board of directors. Luoma and Goodstein (1999) demonstrated that some institutional characteristics shape the stakeholder representation on boards of directors. Typically, these boards include representation from labor, creditors, and regulatory agencies (Schneper and Guillén, 2004). Under this control structure, managerial decisions are therefore monitored and influenced by the presence of stakeholders' representatives (Luoma and Goodstein, 1999). Consequently, this particular composition of a corporate board is likely to affect organizational outcomes and processes (Wood, 1991), in such a way that organizations have to satisfy the needs of a wide variety of stakeholders (Jones, 1995), including both shareholders and non-shareholders.¹

Even the own CEO replacement can be affected by the actions of stakeholders through the conditioning of hostile takeovers. In this sense, Scheper and Guillén (2004) show that the frequency of hostile takeovers is inversely related to stakeholders' (non-shareholders) power, and this result may explain why countries labeled as stakeholder-oriented like Germany or Japan are characterized by the low occurrence of hostile takeovers. Therefore, if stakeholders can influence to some extent the success or failure of takeover initiatives, it is likely that incumbent managers then have enough motivation to committing themselves to socially responsible behavior, aimed at gaining stakeholders' support. Once executives have built close relationships with key stakeholders, they may prove difficult to remove by shareholders. Additionally, over

¹ This stakeholder-centered model of corporate governance is popular in Germany and Japan (Schneper and Guillén, 2004). In Germany, for example, there are two types of limited liability companies, the *Gesellschaft mit beschränkter Haftung* (GMBH) which is not listed, and the *Aktiengesellschaft* (AG), which is a listed company. Both types face the legal obligation of creating a dual level board: The first level is the supervisory board, or *Aufsichtsrat*, which is entrusted to monitor the managers and, the second is the management board or *Vorstand*, responsible for the daily management of the firm. It is important to highlight that workers' representatives and those members elected by shareholders, and who are not employees of the firm, have an equal number of seats in the supervisory board. Directors elected by the shareholders come from other commercial and financial firms which have a long-term, close relationship with the firm and, as such, they are equivalent to the external directors of US firms. It is important to stress that the stakeholder-centered model of corporate governance places greater emphasis on internal mechanisms, such as boards of directors that reflect broad stakeholder participation, in order to discipline managers.

time, executives can gain additional power by controlling the information revealed to stakeholders, thereby reinforcing their entrenchment position (Walsh and Seward, 1990).

3/ HYPOTHESES

In the previous sections, we have argued that the incentives for the efficacy of the board of directors in monitoring and controlling management can be compromised by a variety of entrenchment practices such as poison pills, shark repellents or greenmail and/or disincentives linked to earnings manipulation. Also, we have explained that the independence of the board (including the non-dual role of the CEO), the concentration of ownership and the existence of different boards subcommittees can be effective disciplinary devices to resolve the agency problem. Moreover, stakeholder activism may be another corporate governance device. In fact, we argue that, under some circumstances, stakeholders have the incentives and the power to monitor managers closely. However, even if these corporate governance mechanisms are in place, managers' incentives to seek entrenchment can lead them to find ways to escape these controls. Moreover, managers will have particular incentives to do so when these latter corporate governance mechanisms are well developed. In that case they need powerful entrenchment strategies. One of these strategies is to canvass support from stakeholders so as to channel their efforts to the entrenched manager's own advantage. This strategy enjoys the benefit of diminishing the pressure from activist stakeholders while at the same time opposing the pressure from shareholders that have more difficulty in controlling a manager that has other stakeholders as allies. To operationalize such behavior, managers may engage in a broad array of practices to create and manage relationships with corporate stakeholders and the natural environment, the so-called corporate social performance (CSP). CSP involves, on the one hand, corporate social responsibility (CSR) activities, such as: incorporating social features into products and manufacturing processes; adopting progressive human resource management practices; achieving high levels of environmental performance through recycling and pollution abatement; or advancing the goals of community organizations (McWilliams et al., 2006). While, on the other hand, CSP also involves other activities that are strategically important because they are directly related to the firm's business model, and which include their treatment of employees, communities, nature, and other stakeholders (Waddock, 2004).

A particular objective of this paper is to distinguish the entrenchment perspective of CSP from other competing explanations. Previous literature on stakeholder theory has provided normative, instrumental and descriptive/empirical explanations of CSP (Donaldson and Preston, 1995). The central tenet of normative stakeholder theory is that “the economic and social purpose of the corporation is to create and distribute increased wealth and value to all its primary stakeholder groups, without favoring one group at the expense of others” (Clarkson, 1995: 112), in order to ensure that each primary stakeholder group continues as a part of the corporation. Therefore, CSP is considered to be an end. In contrast to this normative perspective, instrumental theory conceives stakeholder management as a means to achieve the ultimate end of the firm, i.e. marketplace success (Jones, 1995). The basic assumption behind this theory is that the CSP may be an organizational resource that would lead to more efficient or effective use of resources, which in turn has a positive impact on corporate financial performance (Orlitzky et al., 2003).

Our entrenchment arguments for improving CSP clearly do not fit in with the ethical/moral or instrumental arguments discussed above. Managerial self-interested utilization of CSP is explained by the stakeholders’ power to influence the firm. As such, our story belongs to the descriptive realm of stakeholder theory (Mitchell et al., 1997; Jawahar and McLaughlin, 2001). According to this theory, the degree to which managers assign priority to competing stakeholders claims – the stakeholder salience – is positively related to the cumulative number of stakeholders attributes of power, legitimacy, and urgency; considering power as the stakeholders’ capacity to influence the firm’s behavior; legitimacy as the perception that, within a social system of norms, values and beliefs, the actions undertaken by someone are desirable, proper, or appropriate; and urgency is the degree to which a stakeholder’s claim calls for immediate attention (Mitchell et al., 1997). Based on Schreper and Guillén’s (2004) findings, we contemplate power as a function of each stakeholder role in corporate governance. Then, a manager who wants to implement an entrenchment strategy will want to be protected against the actions of powerful stakeholders. In that case, there are two possibilities: collaboration or confrontation.

Jones (1995) and Hill and Jones (1992) supported the confrontation strategy. Jones (1995), in deriving implications of his instrumental theory, suggested that decreases of CSP are connected to a managerial entrenchment strategy. In a similar vein, Hill and Jones (1992) predicted that managers will undertake strategic actions to reduce stakeholder power – strategies that negatively affect corporate efficiency. For

example, management reduces customer power through product and/or market diversification; community power by delocalizing the production outside the regional boundaries; or employee power through several practices of production organization and bureaucratic mechanisms (p. 147).

Our claim is exactly the opposite, we hypothesize that stakeholders and incumbent managers will be natural allies against non-controlling shareholders and potential raiders particularly when there are efficient internal corporate governance mechanisms capable of preventing managerial entrenchment impulses. In that case collaboration with stakeholders cannot be blocked by shareholders easily, on the basis of a “suspicious” entrenchment strategy. This further stimulates managers’ incentives to improve a firm’s CSP with entrenchment intentions. Hellwig (2000) pointed out that managers set on entrenchment will find allies in stakeholder sectors such as the political system, labor, the media, the judiciary, and even in the universities, against outside shareholders. For the incumbent manager, the advantages of an alliance with stakeholders are even more obvious given that stakeholders dispose powerful tools for promoting or disgracing top executives. DeAngelo and DeAngelo (1998) and Hellwig (2000) quoted several examples in which unions, local communities, the media, or customers acted as “white squires” to block hostile takeovers.

In addition, the implementation of expensive policies aimed at improving a firm’s CSP reduces its attractiveness to a raider. Generous long-term contracts with workers and suppliers, as well as long-term commitments to support environmental or philanthropic organizations are a heavy burden to bear by a raider (Pagano and Volpin, 2005). Therefore, anticipating the consequences of generous CSP initiatives in terms of reductions of stakeholder activism as well as reductions in the pressure from existing shareholders and potential raiders, entrenched managers, especially when closely monitored as a result of the internal corporate governance mechanism, will make a commitment to follow socially responsible behavior that gains stakeholders’ support. Thus, our first hypothesis is:

Hypothesis 1. *Managerial entrenchment practices have a positive impact on a firm's social performance. Moreover, this effect is pronounced in those firms with efficient internal corporate governance mechanisms like those with boards that have a large proportion of independent directors; a CEO different from the chairman of the board; different board subcommittees; and concentrated ownership.*

Types of stakeholders: employees

According to Mitchell et al. (1997), the degree to which managers give priority to competing stakeholder claims, the so-called salience, is positively related to the stakeholder attributes perceived by managers. In the previous section, we have distinguished between the salience of shareholders versus other stakeholders. Now, we explore the salience of a particular stakeholder group, the employees.

Within the managerial entrenchment strategy, workers constitute one of the stakeholder groups that receive preferential attention by the manager because they have the capacity to influence a firm's behavior and, at the same time, share common interests with incumbent managers. As a consequence it is likely that entrenched managers, particularly those that face the pressure from efficient internal corporate governance mechanisms, will commit themselves to giving employees more concessions.

The capacity of employees to influence decision-making, organizational arrangements and performance outcomes is well documented in previous literature (see for example, Schenepers and Guillén, 2004). This power is derived from political action or legal mechanisms that are at their disposal. By political action we mean that workers may lobby against/in favor of an incumbent CEO by demonstrating, mobilizing politicians, appealing to the media, and constituting organized pressure groups like trade unions (Pagano and Volpin, 2005). Several studies illustrate, for example, that employees tend to oppose hostile takeovers (Schenepers and Guillén, 2004). In addition, the employees' power to promote or disgrace top executives is amplified when they have institutionalized legal mechanisms at their disposal. One of the most direct means by which employees and other stakeholders protect their individual interests in the corporation, is through the presence of stakeholder directors on corporate boards, or board subcommittees such as the audit, compensation, executive, and nominating

committees (Luoma and Goodstein, 1999). Furthermore, workers can directly affect the likelihood of CEO replacement through individual share ownership.

Importantly, employees are not only a powerful stakeholder group, but are natural allies of managers set on entrenchment. There is a vast literature that demonstrates that hostile takeovers have negative consequences for workers (Aguilera and Jackson, 2003). In countries with low employment protection, a hostile takeover may result in job cuts and, sometimes, causes a worsening in the overall working conditions. For example, successful raiders tend to renegotiate the labor contracts that already exist, cutting wages to a minimum and stepping up monitoring to maintain workers' effort (Conyon et al., 2001).

In addition to the previous arguments, managers may be interested in colluding with employees, not only to gain their support, but also to reduce a firm's attractiveness to potential raiders that may be particularly interested in those companies with efficient internal corporate governance mechanism. In such cases, employment policy is likely to be used to deter hostile takeovers, because generous long-term wage contracts reduce the raider's ability to generate profit from the takeover and, therefore, makes it less attractive (Pagano and Volpin, 2005).

These arguments suggest the following hypothesis:

***Hypothesis 2.** Managerial entrenchment practices have a positive influence on employee performance. Moreover, this effect is pronounced in those firms with efficient internal corporate governance mechanisms like those with boards that have a large proportion of independent directors, and/or with a CEO different from the chairman of the board, and/or with different boards subcommittees and/or with concentrated ownership.*

Performance analysis

The instrumental approach is an important perspective of stakeholder theory (Donaldson and Preston, 1995). It advocates the formulation and implementation of processes that satisfy stakeholders because they control key resources and suggests that stakeholder satisfaction, in turn, will ensure the long-term survival and success of the firm (Freeman, 1984; Hillman and Keim, 2001). Accordingly, stakeholders that own resources relevant to the firm's success will be more willing to offer their resources to the extent that their different claims and needs are fulfilled (Strong et al., 2001). Therefore, under this approach we expect that stakeholder satisfaction leads to higher

commitment, greater effort, and, ultimately, to superior performance (Hosmer, 1994; Stevens et al., 2005). Thus, stakeholder management has strategic value from a “means to an end” perspective (Berman, et al., 1999), which is opposed to the intrinsic value of the normative approach.

However, consistent with our previous propositions, we argue that when managers implement entrenchment practices, improvements in CSP may complement such practices and reinforce the (negative) effect of entrenchment on shareholders’ value. Note that entrenchment decreases the efficiency of external control mechanisms, the hostile takeover, which reduces the pressure on managers and affects detrimentally a firm’s financial performance. Some studies like Walsh and Seward (1990), or more recently, Sundaramurthy (2000) show that capital markets react negatively to the adoption of these practices. Walsh and Seward (1990) also reached the same conclusion using accounting-based measures of performance.

Importantly, Sundaramurthy et al. (1997) and Sundaramurthy (2000) suggest that the strength or weakness of internal monitoring mechanisms, such as the board structure and the ownership concentration, moderate the relationship between anti-takeover provisions and shareholders’ wealth. Remarkably, we have suggested in previous hypotheses, that a manager trying to insulate himself from internal monitoring mechanisms may also follow a generous policy of social concessions. Therefore, these managerial concessions to stakeholders should play a moderating role in the connection between the implementation of entrenchment practices and financial performance. McWilliams and Siegel (2001) termed these types of concessions as discretionary CSP and pointed out that it is negatively related to shareholders’ wealth. Therefore, we expect this moderating role to be negative. Stated formally:

Hypothesis 3: Managerial entrenchment practices when combined with social concessions have a particularly negative impact on financial performance.

Finally, we expect that this result also holds when we focus on the specific dimension of social performance; workers’ satisfaction. This is so because, on the one hand, social concessions to workers are particularly costly and, on the other hand, they will strongly reinforce the entrenchment position of the manager before shareholders given the saliency of these stakeholders to achieve the firm’s success. Both features will amplify the negative impact of entrenchment on performance once combined with workers’ satisfaction:

Hypothesis 4: Managerial entrenchment practices when combined with social concessions to workers have a particularly negative impact on financial performance.

4. METHODS

4.1. Sample and Variables

We compose our sample with 777 industrial firms from 28 different countries that are included at least once in the 2002-2005 SiRi PROTM database. This is compiled by the Sustainable Investment Research International Company (SiRi) – the world’s largest company specializing in socially responsible investment analysis, based in Europe, North America, and Australia. SiRi comprises eleven independent research institutions, such as KLD Research and Analytics Inc. in the USA or Centre Info SA in Switzerland. They provide detailed profiles of the leading international corporations. Companies are analyzed according to their reporting procedures, policies and guidelines, management systems, and key data. This information is extracted from financial accounts, company documentation, international databases, media reports, interviews with key stakeholders, and ongoing contact with management representatives.

The firm’s rating contains 199 information items that cover all major stakeholder issues such as community involvement, environmental impact, customer policies, employment relations, human rights issues, activities in controversial areas (e.g. alcohol), supplier relations, and corporate governance. We complement these data on corporate responsibility with financial data from 2000-2005, extracted from OSIRIS. This is a database compiled by Bureau van Dijk (BvD) and provides information on financials, ownership, earnings, and stock data for the world’s publicly traded companies from over 130 countries. Also, it provides current and historical information on 38,000 companies worldwide, including several thousand unlisted and de-listed companies.

4.2. Measures

Corporate responsibility performance (CSP). CSP is notoriously difficult to operationalize (Aupperle *et al.*, 1985) because it is a multidimensional construct (Carroll, 1979) that captures a wide range of items – ideally, one for each relevant stakeholder (Waddock and Graves, 1997). Until quite recently, many studies used variables associated with only one stakeholder (Wood and Jones, 1995) as a proxy for

the multidimensional construct of CSP as it relates to stakeholders. However, with the emergence of data that covers numerous stakeholders, particularly the KLD data, some of this problem has been corrected (see, e.g., Hillman and Keim, 2001; Berman et al., 1999; Waddock and Graves, 1997).

In the present study, we have used the SiRi PROTM ratings, which include research fields similar to the KLD data and associated with stakeholders. Five research fields are devoted to measuring the level of a firm's responsibilities to its stakeholders: community, customers, employees, environment, and vendors and contractors. Another section provides an overview of firms' corporate governance practices. However, we have excluded this part from our measure of CSP, because in our study we focus on the degree of satisfaction of the non-shareholders' stakeholders. Next, each one of these research fields is evaluated separately and rated on scales ranging from 0 (worst) to 100 (best). This is the score of each stakeholder. Finally, each stakeholder score is weighted according a registered methodology developed by SiRi. These weights are uniform within the sector the firm belongs to. Finally, the *corporate responsibility performance* indicator used in this study is the corresponding SiRi measure defined as the weighted sum of non-shareholders stakeholder scores (the scores of community, customers, employees, environment, and vendors and contractors), using the SiRi's weights.

Workers' satisfaction: We approach this issue using another variable provided by SiRi. In this case, the SiRi analysts assess the level of a firm's responsibilities to its employees, building an aggregate score for this particular stakeholder group. This score is an aggregation of 37 indicators that cover different aspects of the firm's involvement in workers' issues. These indicators are grouped into four broad areas: the level of a firm's transparency or disclosure of information on worker's issues; the existence of corporate policies and principles for employees; the importance of management procedures; and the level of dispute in their relations with employees.

Managerial entrenchment: As discussed in the theoretical section, managers intending to insulate themselves from external monitoring may follow several entrenchment practices. In our case, initially we have used three measures of entrenchment provided by the SiRi PROTM database that approximates the existence of anti-takeover devices, the limitation of shareholders' voting rights, and the existence of multiple classes of stock with different voting rights.² More specifically, *Anti-takeover*

² In the robustness section, we introduce a four measure that we explain there based on earnings management.

is a dummy that it is equal to 1 if the firm has implemented any of the following takeover measures: voting caps, increased voting rights over time, restrictions on board appointment rights, and poison pills. *Shareholders' Rights* is measured by a 3-point Likert scale; the highest value of this item corresponds to the situation in which major controversies have impact on the rights and treatment of shareholders, for example, governance arrangements that affect detrimentally the interests of shareholders; insider trading scandals involving company directors; or major conflicts of interest among board members. The intermediate value indicates the existence of controversies, both major and minor, but where the company has taken credible steps to resolve the problem; and finally, the lowest value indicates that the SiRi analyst did not find any information on controversies involving shareholders of the company. The variable *OneShare_OneVote* is a dummy that it is equal to 1 if the company has multiple classes of stock with different voting rights and zero otherwise.

In addition to providing results using each indicator separately, we also aggregate the scores for the three indicators. The resulting score is labeled as *Entrenchment*. For the sake of robustness, this variable has also been computed using the principal components of the afore-mentioned indicators and the results found remain the same, qualitatively.

Internal corporate governance mechanisms: According to our framework, we control for the strength of internal corporate governance. We use different variables to approach this issue: the independence of the board of directors, the separation of the roles of CEO and chairman, the existence of board subcommittees, and the presence of large shareholders. *Board_Independence* is SiRi's Likert-type variable that takes three different values contingent on the percentage of independent directors with respect to the mean value of the sector. The highest value corresponds to the situation in which a majority of non-executive directors are considered independent; the intermediate value indicates that 50% or less of non-executive directors are independent; and when the information disclosed by the company does not allow us to determine the share of independent non-executive directors, the firm receives the lowest value. *Non-dual_CEO* is a SiRi's dummy variable that it is equal to 1 when the chairman is not the CEO, and zero otherwise.

Audit_Committee, *Nomination_Committee*, and *Remuneration_Committee* are 3 dummy variables obtained from Siri; each one receiving the value 1 if such a committee exists with independent members. Due to the high correlation among these variables, we define *Control_Committee* as a 4-point Likert scale in which 0 represents the

absence of any one of these committees and 3, the joint presence of audit, nomination, and remuneration committees.

Another mechanism of internal control is the role played by large shareholders. We studied this issue by employing measures of stakes in the hands of government, and ownership concentration. *State_Ownership* is the percentage of ownership in the hands of the State; and *Ownership_Concentration* is the stake of the three largest blockholders.³

Finally, in order to study the existence of differential effects of entrenchment on CSP contingent on the aforementioned corporate governance mechanisms, we have crossed the variable of entrenchment with the aforementioned variables but defined as dummies. In particular, we define *DBoard_Independence* as a dummy that it is equal to 1 if the variable of Board_Independence is larger than the mean of the sector for the corresponding year; and zero otherwise. Following the same logic we define *DNon-dual*; *DControl_Committee*; *DState_Ownership* and *DOwnership_Concentration*. Then, we multiply each of these variables by the variable for entrenchment, so as to define different interactive variables that will allow us to study the impact of entrenchment on CSP, in those scenarios where the variables that proxy for corporate governance measures are larger than the mean values for the corresponding sector.

Control variables: We control for financial structure, size, firms' age, performance, investment, growth opportunities, industry, country and year. To control for the financial structure, we use the variable *Debt* that measures the gearing of the company. *Size* is the asset value on a log scale; and *Age* is the number of years of the company's existence. *Performance* is approached through the return on assets, that is, the ratio of the earning before interests and taxes to total value of assets. *Investment* is the ratio of fixed assets to total assets. *Growth* is equal to 1 when the rate of increase in sales is larger than the value for the corresponding sector and year. Finally, we introduce temporal, sectoral and country dummies.

4.3. Empirical Analysis

In our empirical application, we rely on two basic specifications, one explaining variations in CSP and one explaining variations in performance. In order to explain a

³ Alternatively, we have used the stake of the largest shareholder and that of the five largest and the results remain qualitatively the same.

firm's CSP and test Hypotheses 1 and 2, we consider the following basic specification (that also include temporal, sectoral and country dummies):

$$\begin{aligned} \Delta CSP_{it+1} = & \mathbf{a}_1 + \mathbf{a}_2 \Delta \text{Entrenchment}_{it} + \mathbf{a}_3 \Delta \text{Control_Committee}_{it} + \\ & \mathbf{a}_4 \Delta \text{Non-dual_CEO}_{it} + \mathbf{a}_5 \Delta \text{Board_Independence}_{it} + \\ & \mathbf{a}_6 \text{State_Ownership}_{it} + \mathbf{a}_7 \text{Ownership_Concentration}_{it} + \mathbf{a}_8 \text{Growth}_{it} + \\ & \mathbf{a}_9 \text{Size}_{it} + \mathbf{a}_{10} \text{Age}_{it} + \mathbf{a}_{11} \text{ROA}_{it} + \mathbf{a}_{12} \text{Debt}_{it} + \mathbf{a}_{13} \text{Investment}_{it} + \mathbf{e}_{it} \end{aligned} \quad [1]$$

Where Δ represents changes in the variable between one period and the previous one.

In analyzing the possible differential effect of entrenchment strategies, we conducted further estimations of specification [1] by breaking the variable Entrenchment into its three basic components: *Anti-takeover*, *Shareholders_Rights*, and *OneShare_OneVote*. Also, to study differential effects, we also include in the specification the aforementioned interactive variables considering variations in the entrenchment variable (*DBoard_Independence* Δ Entrenchment*; *Non-dual* Δ Entrenchment* , *Control_Committee* Δ Entrenchment*; *State_Ownership* Δ Entrenchment* and *Ownership_Concentration* Δ Entrenchment*).

It is important to stress that by estimating in differences, we eliminate the unobservable heterogeneity that may be potentially correlated with the independent variables. For example, the intrinsic characteristics of the manager should condition a firm's CSP and at the same time may be connected with the governance characteristics of the firm. Additionally, as we have explained in the theoretical section, we expect that pressure from different stakeholders is connected with the internal corporate control mechanisms. That is, an endogeneity problem in specification [1], which it is not directly connected to the unobservable heterogeneity, may exist perfectly. We tackle this problem by advancing the dependent variable by one period.

In order to test Hypothesis 2, we have modified slightly the previous specification by substituting the variable of CSP with that of *Workers' satisfaction*.

The second specification is aimed at explaining the variations in the corporate financial performance. The basic specification is as follows (that also include temporal, sectoral and country dummies):

$$\Delta ROA_{it} = \mathbf{b}_1 + \mathbf{b}_2 \Delta \text{Entrenchment}_{it} + \mathbf{b}_3 \Delta \text{CSP}_{it} + \mathbf{b}_4 \Delta \text{Entrenchment_CSP}_{it} + \mathbf{b}_5 \Delta \text{Control_Committee}_{it} + \mathbf{b}_6 \Delta \text{Non-dual_CEO}_{it} + \mathbf{b}_7 \Delta \text{Board_Independence}_{it} + \mathbf{b}_8 \text{State_Ownership}_{it} + \mathbf{b}_9 \text{Ownership_Concentration}_{it} + \mathbf{b}_{10} \text{Growth}_{it} + \mathbf{b}_{11} \text{Size}_{it} + \mathbf{b}_{12} \text{Age}_{it} + \mathbf{b}_{13} \text{Debt}_{it} + \mathbf{b}_{14} \text{Investment}_{it} + \mathbf{e}'_{it} \quad [2]$$

From this specification, it is possible to test Hypotheses 3 and 4 of whether the variation in the combination of entrenchment and CSP (Hypothesis 3) or workers' satisfaction (Hypothesis 4) have further negative effects on performance compared with simple variations in entrenchment. This test requires the inclusion of an interaction term between CSP and entrenchment practices, the variable *Entrenchment_CSP* for testing Hypothesis 3 or the equivalent variable *Entrenchment_Workers* for testing Hypothesis 4. We have argued that entrenchment initiatives will erode on a larger scale the financial results when they are combined with discretionary corporate social practices affecting all stakeholders or just the workers. These moderation hypotheses would be supported if the coefficient $\mathbf{b}_4 < 0$ and the specification with the interaction term represented a statistically significant improvement over the model including only the direct effects of entrenchment practices on corporate financial performance.

5. RESULTS

Table 1 provides the descriptive statistics of the relevant variables of the model, while Table 2 displays the correlation matrix. On inspection of the correlation matrix, we find that variations in CSP are positively correlated with those of entrenchment. More specifically, variations in CSP are positively correlated with increases in anti-takeover initiatives and with the deterioration of shareholders' rights (at 1% level). Remarkably, these increases in CSP are also negatively correlated with variations in different internal control mechanisms like the existence of independent audit, nomination, and remuneration committees. We interpret this latter result as evidence that when entrenchment is more difficult, as a result of an increase in the aforementioned internal control mechanisms, increases in CSP are also less likely. This complementary result provides preliminary evidence in favor of Hypothesis 1 as we are going to develop using regression techniques (see below). We also have preliminary support for Hypothesis 2, as these results too hold when we focus on variations in workers' satisfaction.

Insert Tables 1 and 2 about here

Table 3 summarizes the regression analysis of specification [1], whereby we test the effect of managerial entrenchment practices on CSP. Further, we break the variable Entrenchment into its three basic components: *Anti-takeover*, *Shareholders_Rights*, and *OneShare_OneVote*.

Insert Table 3 about here

This table shows that variations in entrenchment measures in period t have a positive impact on variations in CSP in period $t+1$ (column 1). This is particularly evident for anti-takeover measures as well as for those actions that limit shareholder rights, which are standard initiatives triggered by an entrenched manager as we have explained in the theoretical section. A second result shows that when entrenchment is more difficult, due to an increase in the number of independent control committees, there is a negative impact on variations in CSP (significant at 1% level). This reflects the complementarities idea between entrenchment and CSP that this paper relies on. However, once we look at the coefficient of the interactive dummies, we find that variations in entrenchment have an impact on variations in CSP only in those scenarios where entrenchment is more difficult. This is because corporate governance is more developed when: there are independent control committees; there is a separation between the posts of CEO and chairman; there are large blockholders - like the state. That is, in such scenarios of well developed corporate governance, if the manager is able to set on entrenchment, he complements this strategy with increases in CSP. This fully conforms to Hypothesis 1, where the collusion with non-shareholder stakeholders is more likely in those scenarios where shareholders can control the manager closely.

In addition, we find that performance is also related negatively to variations in future values of CSP. We argue that in a low-performance scenario, it may be associated perfectly with the existence of entrenchment practices, as we will analyze in Table 5; Managers trigger socially responsible actions so as to complement other entrenchment actions.

Concerning the results, once we focus on workers' satisfaction (see Table 4), they are, in essence, the same as those for the overall score of CSP. This conforms to Hypothesis 2. However, there are two differences. First, the results of workers'

satisfaction are only significant for the specific component of entrenchment that is contained in the implementation of anti-takeover measures. This is in accordance with Pagano and Volpin (2005), where wage concessions – that improve workers’ satisfaction- are described as anti-takeover initiatives. Concerning other measures like the limitation of shareholder rights, we explain that this will not be related to increases in workers’ satisfaction because workers may well have shares in the firm. In fact, the non-significant sign that we obtain may be the result of compensating the positive effect due to managerial concessions to workers with the negative effect due to the limitation of shareholder rights. Second, with regard to the general analysis on stakeholder satisfaction, the positive impact of variations in entrenchment on workers’ satisfaction is concentrated on more specific firms, in comparison with the situation affecting all non-shareholder stakeholders. In particular, only those firms where there is separation between the CEO and the chairman of the board and/or there is state ownership show an impact of entrenchment variation that is positive, when considering increases in workers’ satisfaction. We can argue that having the state as blockholder will provide fewer incentives for controlling managers and prevent entrenchment if these managers look after workers’ interests. This is so because satisfied workers may eventually become constituent members of the current party in government and, firms with public participation has all the incentives to treat them well

Insert Table 4 about here

To analyze the ex-post consequence of implementing entrenchment initiatives combined with increases in CSP, we show in Table 5, the results of estimating specification [2].

Insert Table 5 about here

In column 1, we observe that the implementation of entrenchment actions have a negative impact on performance. However, it is worth stressing that the combination of

these initiatives together with the increase in a firm's CSP is what explains the negative impact on performance. Given this result, we can argue that the only reason for an entrenched manager to satisfy stakeholders' interests is by reinforcing entrenchment. Satisfying other stakeholder interests does not compensate for the negative impact of entrenchment on performance, but increases it. Therefore, given the damage to shareholders' interests, there is a pure entrenchment motive for implementing initiatives aimed at satisfying stakeholders' interests, in a context where a manager chooses entrenchment. A manager needs to respond to the pressure from shareholders whose interests are damaged as financial performance worsens, in two ways. First, they need to look after stakeholders' interests by implementing long-term investment. Second, their own collusion with non-shareholder stakeholders allows them to channel their salience against shareholders' power. Furthermore, this is also true once we focus on workers' satisfaction (see the last column, where the model is also much more significant in comparison with the model without the interactive term).

6/ ROBUSTNESS

6.1/ Earnings Management

In order to investigate the robustness of our results, following our theoretical arguments, we have maintained that earnings manipulation is an additional entrenchment mechanism. Managers manipulate earnings as a natural entrenchment strategy (Fudenberg and Tirole, 1995). Moreover, once earnings are manipulated, managers have further incentives for entrenchment given that although earnings manipulations improve financial performance in the short-term, they damage the medium-term interests of shareholders. The manager anticipates this fact and has all the incentives to trigger entrenchment initiatives. Within this setting, we characterize a situation where we expect to find, according to our theory, an increase in CSP. This is a way to test the robustness of our results.

To test this contention, we follow Jones (1991), Dechow et al. (1995) and Kothari et al (2005) models and we approach earnings management through the discretionary accruals -see the appendix for details-

The result using the discretionary accruals as an entrenchment measure are shown in Table 6. In column 1, we have used the Jones valuation model to compute the

accruals, in column 2, we rely on Dechow et al. (1995) valuation model, and in the last column the valuation model is from Kothari et al. (2005).

Insert Tables 6 about here

From this table we obtain that those firms that manipulate earnings show an increase in CSP. It is important to stress that this is not due to the increase in the short-term financial performance due to earnings management, because we have controlled by a performance variable through the ROA. Our explanation, which supports our basic theory, is that earnings management is connected with entrenchment practices that may further stimulate improvements in CSP. This reinforces the basic claim of the paper.

6.2 Expropriation of minority shareholders

We have conducted an additional analysis to investigate if the changes of CSP and in workers' satisfaction are explained in terms of entrenchment practices or they are a strategy implemented by large shareholders to expropriate minority shareholders. In the corporate governance literature (e.g. Shleifer and Vishny, 1997), the presence of blockholders is contemplated to have an ambiguous effect on firm's financial performance; on the positive side, blockholders diminish the entrenchment possibilities of managers, which impacts positively on performance; but, on the negative side, large shareholders may expropriate minority shareholders thereby reducing the market price of shares. One strategy that blockholders may follow to expropriate minorities is the overinvestment in socially friendly policies (Barnea and Rubin, 2006). By implementing certain social programs, blockholders receive the full benefits associated with CSP, but only bear a portion of the costs to implement such policies (proportional to their stakes). This association between ownership concentration and CSP found support in some recent studies (Barnea and Rubin, 2005; Neubaum and Zahra, 2006).

Keeping in mind this idea, it is important to distinguish the changes of CSP that are connected to the entrenchment practices from those that may be explained in terms of the implementation of expropriating strategies. To do so, in Table 7, we present the results of the basic specification [1], once we distinguish firms according to their ownership concentration. This is proxied by the stake of the three largest blockholders.

Insert Table 7 about here

Remarkably, we have found that the impact of our proxy of entrenchment on variations in CSP and on workers' satisfaction (last two columns) has only positive effects in those firms where ownership is not concentrated (lower than the mean of the sector). In these firms –columns 2 and 4-, we expect that there is no expropriation to minority shareholders. This allows ensuring that the effect found on variation in CSP and in workers' satisfaction is explained exclusively in terms of entrenchment and not in terms of expropriation. This gives further support to our results.

7. CONCLUSIONS

In this paper we have investigated the connection between, on the one hand, the implementation of entrenchment strategies like anti-takeover devices, the limitation of shareholders' voting rights; the existence of multiple classes of stock with different voting rights; and the manipulation of earnings and, on the other hand, the realization of social responsible actions. Our basic premise is that the manager may be controlled by shareholders – externally through the financial markets and internally through the board of directors – as well as by the activism of different stakeholders that have enough power to shape the firm's decision-making. In such a scheme, entrenchment strategies aimed at hindering the actions of shareholders cannot be implemented, unless accompanied by other measures tailored to neutralize stakeholders' pressure. In this case, there are two possibilities: confrontation with stakeholders (a strategy is similar to an entrenched manager at odds with shareholders); or collusion with stakeholders in order to satisfy their interests. Our basic claim is that an entrenched manager will choose the collusion strategy especially in those situations where internal corporate governance mechanisms are well developed and there is little slack for a manager to set on entrenchment. In such cases, the collusion with non-shareholder stakeholders not only will it tackle the pressure from stakeholders but, more importantly, it allows channeling the salience of these stakeholders against agents -shareholders- who intend to replace the manager.

We tested this claim by looking at the connection between variations in different entrenchment proxies and variations in the scores of corporate social performance (CSP). We found that there is a clear positive impact by the former on the latter, especially in those firms with efficient internal corporate governance mechanisms like

the existence of independent control committees and/or when there is a separation between the CEO and the chairman of the board and/or there is public participation. This fully confirms the main theoretical contention of the paper where a firm's CSP is an integral part of manager's definition of an entrenchment strategy.

Additionally, we have proved the robustness of this contention using an alternative proxy of entrenchment that is the implementation of earning manipulation (Fudenberg and Tirole, 1995). The result found using different models for approaching earnings manipulation are fully consistent with our basic claim.

Finally, we carried out an ex-post analysis of the consequences of implementing entrenchment strategies on financial performance and find that its negative impact on financial performance is more pronounced when combined with the implementation of socially responsible actions. This is further evidence that entrenched managers heed stakeholder satisfaction not only as a consequence of stakeholder activism, but also as a way of reinforcing their entrenchment strategy against the shareholders.

Remarkably, our result also holds true when we focus on one of the non-shareholder stakeholders, the workers. We argue that these stakeholders are amongst the most powerful and, consequently, the entrenched manager should pay particular attention to looking after their interests.

Finally, we discard other explanations linked to the implementation of expropriating policies in order to explain the increases in social performance. We have proved that the increases in CSP linked to entrenchment only appear when ownership concentration is low. Expropriation is not found within such a framework; therefore, the increases in CSP are due, exclusively, to entrenchment.

7.1 Implications

This work forms a bridge between the corporate governance literature and stakeholder theory. According to this latter line of research, the management of stakeholders is a good way of improving financial results (Jones, 1995; Donaldson and Preston, 1995), whereas corporate governance emphasizes the difficulty in reconciling the demands of a wide set of stakeholders (Jensen, 2001; Tirole, 2000). We show that trying to satisfy different stakeholders' interests, independently of their salience, may have bad consequences on performance when combined with the implementation of entrenchment policies. Then, it is not a good policy to give the managers any leeway in determining the degree of satisfaction of non-shareholder stakeholders because

managers may define a socially responsible policy strategically to complement an entrenchment strategy. Furthermore, we find that the existence of strong internal corporate governance mechanisms like independent boards or external committees for different control issues is not a guarantee that CSP may not be used in this pervasive way. In fact, the linkage between CSP and entrenchment is stronger for those firms with strong corporate governance mechanism. Then, how does one deal with such a problem?

There are different possibilities. First, following Cespa and Cestone (2004), if a firm's CSP may be used as an integral part of an entrenchment strategy, then, some form of governance mechanism that hinders managerial discretion on social issues is needed. A possibility is to regulate social issues in order to avoid overinvestment in socially responsible actions. Undoubtedly, mandatory accounting practices to reflect these issues on the balance sheet may be a first step in this direction. A second way to prevent entrenchment problems, especially when involving other stakeholders, is to transfer ownership to this group. For example, if workers also have shares in a firm, it will not make sense for the manager to implement simultaneously an entrenchment strategy of confrontation with shareholders and another of collusion with other stakeholders, like workers because the interests of the latter will also be aligned with those of shareholders. Paradoxically, the interests of shareholders are better defended by transferring part of their powers to other stakeholders.

7.2 Future research

A natural extension of our work will be to focus on more specific dimensions of a firm's CSP, in order to study which ones are the most relevant stakeholders for managers who implement an entrenchment strategy. We suggest in the paper that one of the most important groups consists of the workers, but a further analysis of this idea is necessary. Another extension consists of incorporating variables of managerial ownership in the analysis; this is a classical determinant of entrenchment practices. Additionally, it may be worth checking for robustness by comparing results from different countries. The exploration of this issue may be relevant given the significant differences that exist in top-management orientation across countries. In Anglo-Saxon countries, managers are more inclined to satisfy shareholders' interests, while in Continental Europe and Japan, managers have traditionally been more sensitive to the development of long-term relationships with employees, banks, and suppliers. The investigation of this as well as other issues is left for future research.

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Appendix: Earnings Management

We approach earnings management through the discretionary accruals (DA), where accruals are defined as:

$$Accruals = (\Delta CA - \Delta Cash) - (\Delta CL - \Delta STD) - DEP \quad [3]$$

?CA is the change in current assets; ?Cash is the change in cash; ?CL is the change in current liabilities; ?STD is the change in debt included in current liabilities; and DEP is the depreciation and amortization.

Then, we use a valuation model, to obtain an estimated value of a firm's accruals, according to sector, country as well as its characteristics like the variations of sales and the proportion of tangible assets. In particular, we use three different models, the Jones (1991), Dechow *et al.* (1995), and the Kothari (2005) models. These different models are derivations from the original Jones model that estimates the total accruals on the change in sales (?Sales) and property, plant and equipment (PPE). In the Jones model, discretionary accruals are estimated by cross-section each year, using all firm-year observations in the same two-digit SIC code. In our application, however, we do not have enough observations to perform a cross-sectional estimation in each two-digit SIC code. A solution to this problem is to perform cross-sectional estimations for pooled data with dummy variables denoting each sector. This estimation strategy has been used in several papers (Kang and Sivaramakrishnan, 1995; Han and Wang, 1998). Moreover, as we make use of an international database, we expect to find large differences in the level of earnings management across countries (Leuz *et al.*, 2003). Due to all these reasons, and considering the number of sectors (10) and countries (28) in our data, we propose the following modification of the Jones model:

$$\begin{aligned} \frac{Accruals_{it}}{A_{i,t-1}} = & \mathbf{a}_0 + \mathbf{a}_1 \left(\frac{1}{A_{i,t-1}} \right) + \mathbf{a}_2 \left(\frac{\Delta Sales_{it}}{A_{i,t-1}} \right) + \mathbf{a}_3 \left(\frac{PPE_{it}}{A_{i,t-1}} \right) \\ & + \sum_{j=4}^{12} \mathbf{a}_j (Sector_{it}) + \sum_{j=13}^{40} \mathbf{a}_j (Country_{it}) + \sum_{j=41}^{43} \mathbf{a}_j (Year_{it}) + \mathbf{e}_{it} \end{aligned} \quad [4]$$

Where A refers to total assets, Sector, Country and Year sets are dichotomous variables that capture industry, country and temporal effects. The expected portion of total accruals, the non-discretionary accruals (NDA), is calculated using the regression coefficients from equation [4]. In particular:

$$\begin{aligned} \frac{Accruals_{it}}{A_{i,t-1}} = & \hat{\mathbf{a}}_0 + \hat{\mathbf{a}}_1 \left(\frac{1}{A_{i,t-1}} \right) + \hat{\mathbf{a}}_2 \left(\frac{\Delta Sales_{it}}{A_{i,t-1}} \right) + \hat{\mathbf{a}}_3 \left(\frac{PPE_{it}}{A_{i,t-1}} \right) \\ & + \sum_{j=4}^{12} \hat{\mathbf{a}}_j (Sector_{it}) + \sum_{j=13}^{40} \hat{\mathbf{a}}_j (Country_{it}) + \sum_{j=41}^{43} \hat{\mathbf{a}}_j (Year_{it}) \end{aligned} \quad [5]$$

From the non-discretionary accruals, NDA, we compute the discretionary accruals, DA, as follows:

$$DA_{it}^J = \left(\frac{Accruals_{it}}{A_{i,t-1}} \right) - NDA_{it}^J \quad [6]$$

The superscript J denotes the Jones model. In this model, the change in sales is used to control for firms' growth since working capital is closely related to sales, while PPE is used to control for depreciation expenses contained in accruals. As a result, NDA are the expected accruals given the firm's growth and fixed assets, while DA represents the unexpected accruals. This is our proxy of earnings management that we use in column 1 of Table 6. In column 2, we repeat the process but we rely on Dechow et al. (1995) as the valuation model. This model is a minor modification of the Jones model, where the only difference is that instead of considering the variation in sales in equation [5], it uses the variation in sales net of changes in receivables. Finally, in the last column, we use the valuation model of Kothari et al. (2005), where the only difference from the Jones model is the inclusion of the returns on assets as an additional explicative variable of the non-discretionary accruals.

TABLE 1: Descriptive Statistics

	N	Mean	Std. Dev.	Min	Max
CSP	1716	0.53	0.14	0.10	0.87
Employee performance	1716	0.54	0.15	0.00	0.97
Anti-takeover	1164	0.69	0.46	0.00	1.00
OneShare_OneVote	1315	0.25	0.44	0.00	1.00
Shareholders_Rights	1315	0.04	0.15	0.00	1.00
Control_Committee	1315	1.35	1.40	0.00	3.00
Non-dual_CEO	993	0.65	0.48	0.00	1.00
Board_Independence	993	0.81	0.38	0.00	1.00
? CSP	1185	0.02	0.10	-0.31	0.59
? Anti-takeover	445	-0.61	0.49	-1.00	0.00
? OneShare_OneVote	539	-0.02	0.27	-1.00	1.00
? Shareholders_Rights	539	-0.01	0.18	-1.00	1.00
? Control_Committee	539	2.22	1.17	-1.00	3.00
? Non-dual_CEO	539	0.02	0.24	-1.00	1.00
? Board_Independence	539	0.07	0.30	-1.00	1.00
Growth	2337	0.07	0.26	0.00	1.00
State_Ownership	2337	0.86	5.71	0.00	100.00
Ownership_Concentration	2337	26.14	14.77	0.61	151.15
Size	998	16.15	1.37	11.56	20.44
Age	2337	69.67	29.29	1.00	339.00
Performance	998	4.18	12.12	-207.47	45.80
Debt	977	111.15	147.75	-932.67	974.68
Investment	998	0.58	0.20	0.01	0.99

TABLE 2: Correlation Matrix ¹

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
?CSP	1																
?Entrenchment	0.1691*	1															
?Employee performance	0.5677*	0.1582*	1														
?Anti-takeover	0.1473*	0.8457*	0.1757*	1													
?OneShare_OneVote	0.0900*	0.5002*	0.0494	0.0729	1												
?Shareholders_Rights	0.0309	0.3073*	-0.0121	-0.0058	0.0188	1											
?Control_Committee	-0.2226*	-0.3211*	-0.2601*	-0.4105*	0.0253	0.0075	1										
?Non-dual_CEO	0.0226	0.0036	0.0065	0.0297	0.0342	-0.0638	0.051	1									
?Board_Independence	0.0800	0.0268	-0.0479	-0.0291	-0.019	0.0988*	0.0154	-0.1552*	1								
) Growth	0.0022	-0.0069	0.0448	-0.0194	0.0243	-0.0115	-0.0452	0.0967*	-0.0084	1							
. State_Ownership	-0.0200	-0.0022	0.0417	0.047	-0.0417	-0.0628	-0.0408	-0.0515	-0.0689	0.0667*	1						
! Ownership_Concentration	0.0089	-0.0256	0.0463	-0.0279	0.0176	-0.0366	-0.0503	0.0974*	-0.06	0.1564*	0.2105*	1					
} Size	-0.1713*	-0.0905*	-0.1570*	-0.1268*	-0.0128	0.0547	0.1842*	-0.0116	0.0215	-0.031	0.0853*	-0.077*	1				
Age	-0.0813*	0.0371	-0.0104	0.0093	0.0499	0.016	0.0159	0.0458	-0.0246	0.0172	0.0132	0.0216	0.0381	1			
~ Performance	-0.0656*	-0.028	0.0051	-0.0483	-0.0558	0.1186*	0.1372*	0.0547	0.0104	-0.0189	-0.0117	-0.0096	-0.0471	0.0796*	1		
^ Debt	-0.0373	-0.0344	-0.0576	-0.0352	0.0505	-0.0968*	0.0253	-0.0423	-0.0596	-0.1103*	0.0859*	-0.002	0.3066*	0.0297	-0.037	1	
^ Investment	-0.0179	-0.0626	-0.0321	-0.0798	0.0036	-0.0017	0.1230*	-0.1244*	0.1304*	-0.0124	-0.0245	0.0394	0.3938*	-0.0399	-0.12*	0.216*	1

* Significant at 1% level.

TABLE 3 The impact of Entrenchment on Corporate Social Performance (CSP)

Table 3 reports the results of conducting robust regressions on the variations (?) of entrenchment as well as different governance mechanism on the variation (?) in a firm's CSP (lead by one period). The variations (?) of the independent variables are taken between period t and period t-1, while that of the dependent variable between period t+1 and t. The variable of CSP is the score provided by SiRi once we have detracted the component on corporate governance. *Anti-takeover* is a dummy that it is equal to 1 if the firm has implemented any takeover measures and zero otherwise. *OneShare_OneVote*, is a dummy that it is equal to 1 if there are dual class shares and zero otherwise. *Shareholders_Rights* is a variable that takes three values (0, 0.5, 1) depending on the degree of limitation of shareholders' voting rights. Then, $Entrenchment = Anti-takeover + OneShare_OneVote + Shareholders_Rights$. *Control_committee* is the sum of the following three variables: *Nomination_Committee* is a dummy that it is equal to 1 if there is a nomination committee with independent members and zero otherwise. *Remuneration_Committee* is a dummy that it is equal to 1 if there is a remuneration committee with independent members and zero otherwise. *Audit_Committee* is a dummy that it is equal to 1 if there is an audit committee with independent members and zero otherwise. *Non-dual_CEO* is a dummy that it is equal to 1 when the chairman is not the CEO and zero otherwise. *Board_Independence* is a variable that takes three different values (0, 0.5 and 1) contingent on the percentage of independent directors with respect to the mean value of the sector. *State_Ownership* is the stake in the hands of the state. *Ownership_Concentration* is the stake of the three largest blockholders. The crossed variable $DControl_Committee * ?Entrenchment$ is the result to multiply ?Entrenchment by a dummy *DControl_Committee* that is equal to 1 if *Control_Committee* is larger than the value of the sector for the corresponding year and zero otherwise. Following the same pattern, we define $DNon-dual_CEO * ?Entrenchment$; $DBoard_Independence * ?Entrenchment$; $DState_Ownership * ?Entrenchment$; $DOwnership_Concentration * ?Entrenchment$. *Growth* is equal to 1 when the rate of increase in sales is larger than the value for the corresponding sector and year. *Size* is the vale of assets in a log scale. *Age* is the firm's age. *Performance* is approached through the return on asset (ROA). *Debt* is the firm's gearing. *Investment* is the ratio of fixed to of the total assets. Finally, we have controlled by year, sector and country by introducing the corresponding dummy variables.

Dependent Variable	?CSP ¹	?CSP ¹	?CSP ¹
?Anti-takeover	2.234** (2.130)		
?OneShare_OneVote	1.907 (-1.300)		
?Shareholders_Rights	5.377** (-2.180)		
?Entrenchment		2.450*** (3.16)	-0.266 (-0.190)
?Control_Committee	-1.322*** (-2.620)	-1.318*** (-2.660)	-1.579*** (-3.150)
?Non-dual_CEO	-0.208 (-0.110)	-0.461 (-0.25)	-2.746 (-1.400)
?Board_Independence	0.294 (0.190)	0.449 (0.29)	0.957 (0.580)
State_Ownership	-0.035 (-0.430)	-0.038 (-0.48)	-0.126* (-1.610)
Ownership_Concentration	-0.020 (-0.840)	-0.020 (-0.82)	-0.039 (-1.290)
DControl_Committee*?Entrenchment			4.810* (1.710)
DNon-dual_CEO*?Entrenchment			4.482*** (4.050)
DBoard_Independence*?Entrenchment			-0.485 (-0.410)
DState_Ownership*?Entrenchment			4.324* (1.740)
DOwnership_Concentration*?Entrenchment			-2.449 (-1.540)
Growth	2.234* (1.670)	2.209* (1.65)	2.095* (1.570)
Size	-2.920*** (-6.610)	-2.869*** (-6.6)	-2.977*** (-6.840)
Age	-0.020** (-1.940)	-0.020** (-1.96)	-0.030*** (-2.750)
Performance	-0.197*** (-2.510)	-0.183*** (-2.4)	-0.158** (-1.850)
Debt	0.000 (-0.050)	0.000 (-0.11)	-0.001 (-0.150)
Investment	-2.415 (-0.870)	-2.330 (-0.84)	-2.676 (-0.950)
Intercept	63.545*** (7.220)	62.977*** (7.2)	65.336*** (7.310)
R ²	41.87	41.62	45.96
F test	14.62 (0.000)	16.09 (0.000)	10.17 (0.000)
# observations	338	338	338

¹***p-value 0.01, ** p-value 0.05, *p-value 0.10. In parentheses the p-values

TABLE 4 The Impact of Entrenchment on Workers' Satisfaction

Table 4 reports the results of conducting robust regressions on the variations (?) of entrenchment as well as different governance mechanism on the variation (?) in workers' satisfaction (lead by one period). The variations (?) of the independent variables are taken between period t and period t-1, while that of the dependent variable between period t+1 and t. The variable of *workers' satisfaction* is the score provided by SiRi of the degree of satisfaction of these stakeholders. *Anti-takeover* is a dummy that it is equal to 1 if the firm has implemented any takeover measures and zero otherwise. *OneShare_OneVote*, is a dummy that it is equal to 1 if there are dual class shares and zero otherwise. *Shareholders_Rights* is a variable that takes three values (0, 0.5, 1) depending on the degree of development of limitation of shareholders' voting rights. Then, $Entrenchment = Anti-takeover + OneShare_OneVote + Shareholders_Rights$. *Control_committee* is the sum of the following three variables: *Nomination_Committee* is a dummy that it is equal to 1 if there is a nomination committee with independent members and zero otherwise. *Remuneration_Committee* is a dummy that it is equal to 1 if there is a remuneration committee with independent members and zero otherwise. *Audit_Committee* is a dummy that it is equal to 1 if there is an audit committee with independent members and zero otherwise. *Non-dual_CEO* is a dummy that it is equal to 1 when the chairman is not the CEO and zero otherwise. *Board_Independence* is a variable that takes three different values (0, 0.5 and 1) contingent on the percentage of independent directors with respect to the mean value of the sector. *State_Ownership* is the stake in the hands of the state. *Ownership_Concentration* is the stake of the three largest blockholders. The crossed variable $DControl_Committee * ?Entrenchment$ is the result to multiply ?Entrenchment by a dummy *DControl_Committee* that is equal to 1 if *Control_Committee* is larger than the value of the sector for the corresponding year and zero otherwise. Following the same pattern, we define $DNon-dual_CEO * ?Entrenchment$; $DBoard_Independence * ?Entrenchment$; $DState_Ownership * ?Entrenchment$; $DOwnership_Concentration * ?Entrenchment$. *Growth* is equal to 1 when the rate of increase in sales is larger than the value for the corresponding sector and year. *Size* is the vale of assets in a log scale. *Age* is the firm's age. *Performance* is approached through the return on asset (ROA). *Debt* is the firm's gearing. *Investment* is the ratio of fixed to of the total assets. Finally, we have controlled by year, sector and country by introducing the corresponding dummy variables.

Dependent Variable	?Workers' satisfaction ¹	?Workers'satisfaction ¹	?Workers'satisfaction ¹
? Anti-takeover	3.411** (2.190)		
?OneShare_OneVote	0.872 (-0.400)		
?Shareholders_Rights	1.249 (-0.310)		
?Entrenchment		2.464** (2.080)	0.891 (0.45)
?Control_Committee	-2.244*** (-3.400)	-2.369*** (-3.620)	-2.252*** (-3.16)
?Non-dual_CEO	-2.266 (-0.900)	-2.053 (-0.840)	-4.080 (-1.46)
?Board_Independence	-4.161** (-2.040)	-4.348** (-2.170)	-4.999** -2.14)
State_Ownership	-0.041 (-0.410)	-0.030 (-0.290)	-0.025 (-0.22)
Ownership_Concentration	-0.011 (-0.350)	-0.012 (-0.390)	-0.053 (-1.24)
DControl_Committee*?Entrenchment			2.214 (0.550)
DNon-dual_CEO*?Entrenchment			3.038** (1.920)
DBoard_Independence*?Entrenchment			0.110 (0.060)
DState_Ownership*?Entrenchment			8.709*** (2.450)
DOwnership_Concentration*?Entrenchment			-3.267 (-1.440)
Growth	0.524 (0.300)	0.505 (0.290)	1.242 (0.65)
Size	-2.624*** (-4.180)	-2.643*** (-4.210)	-2.490*** (-4.01)
Age	0.010 (0.790)	0.010 (0.740)	0.006 (0.36)
Performance	-0.182* (-1.710)	-0.178* (-1.720)	-0.194 (-1.58)
Debt	-0.002 (-0.370)	-0.002 (-0.380)	-0.002 (-0.38)
Investment	-1.170 (-0.320)	-1.077 (-0.290)	0.249 (0.06)
Intercept	52.671*** (5.890)	52.257*** (5.860)	48.436*** (3.8)
R ²	30.76	30.56	33.94
F test	10.39 (0.000)	11.17 (0.000)	6.08 (0.000)
# observations	338	338	338

¹***p-value 0.01, ** p-value 0.05, *p-value 0.10. In parentheses the P-values.

TABLE 5: The Moderating Role of CSP connecting Entrenchment and Performance

Table 5 reports the results of conducting robust regressions on the variations (?) of entrenchment and CSP as well as their interaction on variations in a firm's financial performance. The variations (?) of the independent variables are taken between period t and period t-1. The dependent variable ? *Performance* is approached through the return on asset (ROA). The variable of *CSP* is the score provided by SiRi once we have detracted the component on corporate governance. The variable of *Workers' satisfaction* is the score provided by SiRi of the degree of satisfaction of these stakeholders. *Entrenchment*=*Anti-takeover*+*OneShare_OneVote*+*Shareholders_Rights*, where *Anti-takeover* is a dummy that it is equal to 1 if the firm has implemented any takeover measures and zero otherwise. *OneShare_OneVote* is a dummy that it is equal to 1 if there are dual class shares and zero otherwise. *Shareholders_Rights* is a variable that takes three values (0, 0.5, 1) depending on the degree of limitation of shareholders' voting rights. *Entrenchment_CSP* is the product of *entrenchment* by *CSP*. *Entrenchment_Workers* is the product of *entrenchment* by *workers' satisfaction*. *Control_committee*=*Nomination_Committee*+*Remuneration_Committee*+*Audit_Committee*, where *Nomination_Committee* is a dummy that it is equal to 1 if there is a nomination committee with independent members and zero otherwise. *Remuneration_Committee* is a dummy that it is equal to 1 if there is a remuneration committee with independent members and zero otherwise. *Audit_Committee* is a dummy that it is equal to 1 if there is an audit committee with independent members and zero otherwise. *Non-dual_CEO* is a dummy that it is equal to 1 when the chairman is not the CEO and zero otherwise. *Board_Independence* is a variable that takes three different values (0, 0.5 and 1) contingent on the percentage of independent directors with respect to the mean value of the sector. *State_Ownership* is the stake in the hands of the state. *Ownership_Concentration* is the stake of the three largest blockholders. *Growth* is equal to 1 when the rate of increase in sales is larger than the value for the corresponding sector and year. *Size* is the vale of assets in a log scale. *Age* is the firm's age. *Debt* is the firm's gearing. *Investment* is the ratio of fixed assets to total assets. Finally, we have controlled by year, sector and country by introducing the corresponding dummy variables.

Dependent Variable	?Performance ¹	?Performance ¹	?Performance ¹
?Entrenchment	-1.083** (-2.070)	0.782 (1.460)	0.785 (1.310)
? CSP		0.011 (0.430)	
?Entrenchment_CSP		-0.021** (-2.070)	
?Workers_Satisfaction			0.022 (0.880)
?Entrenchment_Workers			-0.019** (-1.810)
?Control_Committee	0.385 (0.720)	0.134 (1.030)	0.104 (0.800)
?Non-dual_CEO	0.840 (0.740)	0.086 (0.150)	0.091 (0.160)
?Board_Independence	0.217 (0.260)	0.771** (1.800)	0.730* (1.660)
State_Ownership	0.075 (0.970)	-0.014 (-0.600)	-0.013 (-0.560)
Ownership_Concentration	-0.025 (-1.530)	0.000 (0.060)	0.000 (0.050)
Growth	1.682 (1.460)	0.527** (1.890)	0.496* (1.720)
Size	0.504 (0.540)	0.128 (0.920)	0.116 (0.810)
Age	-0.017* (-1.830)	-0.005* (-1.670)	-0.005 (-1.400)
Debt	0.004 (0.430)	-0.001 (-0.590)	-0.001 (-0.680)
Investment	-3.913** (-1.930)	-1.170 (-1.380)	-1.228 (-1.420)
Intercept	-5.167 (-0.360)	-0.980 (-0.450)	-0.760 (-0.340)
R ²	15.24	20.13	67.958
Fitness of the model (F test)	14.17 (0.000)	1.63 (0.056)	13.03 (0.000)
Number of observations	151	151	151

¹***p-value 0.01, ** p-value 0.05, *p-value 0.10. In parentheses the P-values.

TABLE 6. Earnings Management as proxy of entrenchment

Table 6 reports the results of conducting regressions on the variations (?) of earnings management as well as different governance mechanism on the variation (?) in a firm's CSP (lead by one period). The variations (?) of the independent variables are taken between period t and period t-1, while that of the dependent variables between period t+1 and t. Columns 1 approaches earnings management through the discretionary accruals given in the Jones (1991) model (see the Appendix for details). In column 2, we use the Dechow et al, (1995) model to compute the discretionary accruals, while in column 3, we use the Kothari et al., (2005) model. The variable of CSP is the score provided by SiRi once we have detracted the component on corporate governance. *Workers' satisfaction* is the score provided by SiRi of the degree of satisfaction of these stakeholders. *Entrenchment=Anti-takeover+OneShare_OneVote+Shareholders_Rights*, where *Anti-takeover* is a dummy that it is equal to 1 if the firm has implemented any takeover measures and zero otherwise. *OneShare_OneVote* is a dummy that it is equal to 1 if there are dual class shares and zero otherwise. *Shareholders_Rights* is a variable that takes three values (0, 0.5, 1) depending on the degree of limitation of shareholders' voting rights. *Control_committee=Nomination_Committee+Remuneration_Committee+Audit_Committee*, where *Nomination_Committee* is a dummy that it is equal to 1 if there is a nomination committee with independent members and zero otherwise. *Remuneration_Committee* is a dummy that it is equal to 1 if there is a remuneration committee with independent members and zero otherwise. *Audit_Committee* is a dummy that it is equal to 1 if there is an audit committee with independent members and zero otherwise. *Non-dual_CEO* is a dummy that it is equal to 1 when the chairman is not the CEO and zero otherwise. *Board_Independence* is a variable that takes three different values (0, 0.5 and 1) contingent on the percentage of independent directors with respect to the mean value of the sector. *State_Ownership* is the stake in the hands of the state. *Ownership_Concentration* is the stake of the three largest blockholders. *Growth* is equal to 1 when the rate of increase in sales is larger than the value for the corresponding sector and year. *Size* is the value of assets in a log scale. *Age* is the firm's age. *Performance* is approached through the return on asset (ROA). *Debt* is the firm's gearing. *Investment* is the ratio of fixed assets to total assets.. Finally, we have controlled by year, sector and country by introducing the corresponding dummy variables.

Dependent Variable	?CSP ¹	?CSP ¹	?CSP ¹
Earnings_Management (Jones, 1991)	16.264*** (2.590)		
Earnings_Management (Dechow et al, 1995)		14.957*** (2.470)	
Earnings_Management (Kothari et al, 2005.)			14.418*** (2.370)
?Control_Committee	-1.537*** (-2.980)	-1.548*** (-3.000)	-1.549*** (-3.000)
?Non-dual_CEO	-0.301 (-0.170)	-0.263 (-0.150)	-0.285 (-0.160)
?Board_Independence	0.913 (0.580)	0.916 (0.580)	0.923 (0.590)
State_Ownership	-0.038 (-0.470)	-0.038 (-0.480)	-0.038 (-0.480)
Ownership_Concentration	-0.014 (-0.600)	-0.013 (-0.580)	-0.013 (-0.560)
Growth	2.671** (1.970)	2.552** (1.890)	2.531** (1.880)
Size	-2.792*** (-6.410)	-2.805*** (-6.450)	-2.814*** (-6.490)
Age	-0.019** (-1.840)	-0.019 (-1.810)	-0.019** (-1.800)
Performance	-0.161** (-2.090)	-0.161** (-2.080)	-0.153** (-1.960)
Debt	0.000 (0.030)	0.000 (0.030)	0.000 (0.030)
Investment	-2.256 (-0.810)	-2.166 (-0.780)	-2.173 (-0.780)
Intercept	57.326*** (6.580)	57.623*** (6.640)	57.925*** (6.710)
R ²	40.98	40.92	40.86
Fitness of the model (F test)	16.07 (0.000)	15.89 (0.000)	15.85 (0.000)
Number of observations	338	338	338

1***p-value 0.01, ** p-value 0.05, *p-value 0.10. In parentheses the p-values

TABLE 7. The Expropriating Effect

Table 6 reports the results of conducting regressions on the variations (?) of entrenchment as well as different governance mechanism on the variation (?) in a firm's CSP (lead by one period) and *workers' satisfaction* (last two columns). The variations (?) of the independent variables are taken between period t and period t-1, while that of the dependent variables between period t+1 and t. Columns 1 and 3 (2 and 4) focus on those firms such that the stake of the three largest blockholders is larger (lower) than the mean of the sector for the corresponding year—*concentration = 1 (0)*. The variable of CSP is the score provided by SiRi once we have detracted the component on corporate governance. *Workers' satisfaction* is the score provided by SiRi of the degree of satisfaction of these stakeholders. *Entrenchment=Anti-takeover+OneShare_OneVote+Shareholders_Rights*, where *Anti-takeover* is a dummy that it is equal to 1 if the firm has implemented any takeover measures and zero otherwise. *OneShare_OneVote* is a dummy that it is equal to 1 if there are dual class shares and zero otherwise. *Shareholders_Rights* is a variable that takes three values (0, 0.5, 1) depending on the degree of limitation of shareholders' voting rights. *Control_committee=Nomination_Committee+Remuneration_Committee+Audit_Committee*, where *Nomination_Committee* is a dummy that it is equal to 1 if there is a nomination committee with independent members and zero otherwise. *Remuneration_Committee* is a dummy that it is equal to 1 if there is a remuneration committee with independent members and zero otherwise. *Audit_Committee* is a dummy that it is equal to 1 if there is an audit committee with independent members and zero otherwise. *Non-dual_CEO* is a dummy that it is equal to 1 when the chairman is not the CEO and zero otherwise. *Board_Independence* is a variable that takes three different values (0, 0.5 and 1) contingent on the percentage of independent directors with respect to the mean value of the sector. *State_Ownership* is the stake in the hands of the state. *Ownership_Concentration* is the stake of the three largest blockholders. *Growth* is equal to 1 when the rate of increase in sales is larger than the value for the corresponding sector and year. *Size* is the value of assets in a log scale. *Age* is the firm's age. *Performance* is approached through the return on asset (ROA). *Debt* is the firm's gearing. *Investment* is the ratio of fixed assets to total assets.. Finally, we have controlled by year, sector and country by introducing the corresponding dummy variables.

Dependent Variable	?CSP ¹	?CSP ¹	?Workers'satisfac ¹	?Workers'satisfac ¹
	Ownership Concentration=1	Ownership Concentration=0	Ownership Concentration=1	Ownership Concentration=0
?Entrenchment	1.862 (1.250)	3.359*** (3.100)	1.622 (0.790)	3.481** (2.220)
?Control_Committee	-0.680 (-0.770)	-1.657*** (-2.850)	-2.138 (-1.750)	-2.371*** (-2.820)
?Non-dual_CEO	2.739 (0.680)	-3.267 (-1.340)	-3.450 (-0.620)	-0.917 (-0.260)
?Board_Independence	-2.639 (-0.720)	1.170 (0.630)	-5.247 (-1.030)	-4.141 (-1.530)
State_Ownership	0.053 (0.330)	-0.055 (-0.600)	-0.087 (-0.390)	0.014 (0.110)
Ownership_Concentration	-0.055 (-1.110)	-0.090 (-0.960)	-0.010 (-0.150)	-0.014 (-0.110)
Growth	6.267*** (2.510)	0.340 (0.210)	3.158 (0.910)	-0.489 (-0.210)
Size	-2.689*** (-3.020)	-2.767*** (-5.220)	-2.662** (-2.160)	-2.654*** (-3.470)
Age	-0.012 (-0.490)	-0.024** (-1.950)	0.011 (0.340)	0.012 (0.640)
Performance	-0.179 (-0.970)	-0.183* (-1.670)	-0.033 (-0.130)	-0.248 (-1.560)
Debt	-0.002 (-0.290)	0.001 (0.110)	-0.002 (-0.190)	-0.004 (-0.510)
Investment	1.925 (0.290)	-4.156 (-1.230)	1.757 (0.190)	-1.165 (-0.240)
Intercept	51.719*** (3.530)	65.688*** (6.230)	57.764*** (2.850)	57.538*** (3.770)
R ²	41.91	46.81	36.36	31.13
Fitness of the model (F test)	3.02 (0.000)	8.63 (0.000)	2.39 (0.002)	4.43 (0.000)
Number of observations	110	228	110	228

¹***p-value 0.01, ** p-value 0.05, *p-value 0.10. In parentheses the p-values