Corporate Social Responsibility and Managerial Entrenchment.

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Summary

When stakeholder protection is left to the voluntary initiative of managers, relations with stakeholders and social activists may turn into a powerful entrenchment strategy for incumbent CEOs. This is particularly true in countries and periods where political lobbying, social activism and media campaigns have the power to promote or disgrace top executives of large corporations. [1] Inefficient managers have then a special motive for committing themselves to a socially responsible behavior that gains stakeholders' support. This paper suggests that explicit stakeholder protection - whether enforced by courts and regulators, or by private monitoring institutions specialized in corporate social responsibility (CSR) issues - can break this alliance, thus favoring control contestability and managerial turnover.

We propose a simple model where stakeholders other than shareholders can affect the likelihood of CEO replacement, and incumbent CEOs can make *manager-specific* commitments to adopt a stakeholder-friendly behavior. This subtle entrenchment strategy becomes more appealing to CEOs when corporate law and the firm's charter promote independent boards, proxy fights and hostile takeovers. When deciding whether to support the incumbent CEO against a takeover or a proxy fight, stakeholder activists trade off the cost of a less

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[1] There is by now a large consensus that stakeholders enjoy substantial *effective* control on firms by the threat of costly boycotts and media campaigns. Local communities, unions and environmental organizations also interfere in corporate governance matters by acting as "white squires" to block hostile takeovers. Indeed, some recent controversial takeover contests displayed incumbent CEOs relying on activists' and media support to buttress their positions.

talented manager against the benefit of managerial concessions. The latter are less valuable if stakeholders expect to receive a fair treatment *independently* of who runs the firm. Within this framework, we show the following facts. First, when private benefits of control are large and stakeholder activism is effective, shareholder value is enhanced when explicit stakeholder protection is introduced, so as to undermine corporate officers' entrenchment strategies. Our theory thus rationalizes why firms increasingly submit their behavior to the monitoring of ethic indexes and social auditors in an attempt to make CEOs less central to relations with stakeholders. Second, we show that although stakeholders may support an inefficient CEO committed to a socially responsible behavior against an alternative manager, stakeholder welfare is always increasing in the degree of control contestability. This is because CEOs who can rely on anti-takeover defenses and dominated boards do not need stakeholders' support to buttress their positions. In light of the former findings, stakeholders and shareholders have more interests in common than one would expect. Finally, we show that inefficient CEOs are always opposed to any institutionalization of stakeholder protection which would deprive them of discretionality over CSR and thus of their grip on stakeholders.

Our work contributes to rationalize a recent trend whereby social activists and shareholders are growing increasingly supportive of each others' agendas, as corroborated by the following stylized facts:

Shareholders' support for explicit stakeholder protection.

Mainstream shareholder activists and institutional investors are asking firms to institutionalize stakeholder protection, rather than leave it in the hands of CEOs. Firms then resort to specialized institutions whose role is to monitor their environmental and social performance and report it to the public. Indeed, consulting firms are increasingly specializing in social auditing, while stock market ethic indexes are being created to respond to shareholders' demand for certified "ethic stocks. Our theory adds to the common wisdom explanation for this phenomenon - i.e. that shareholders endorse explicit CSR measures simply because they fear costly boycotts - by linking shareholder value, corporate governance factors, and CSR. In particular, while the boycott rationale implies that in the presence of powerful activists shareholders benefit from the stock's inclusion in sustainability indexes, our model yields the additional prediction that firms' incentive to undergo ethical screening for inclusion in such indexes is stronger when corporate control is more contestable.

Social activists' interest for corporate governance issues.

Social and environmental activists are increasingly involved in the corporate governance debate. Many activists have in fact joined forces with shareholders' lobbies to campaign against anti-takeover devices, CEO-dominated boards and lenient auditors, issues that used to be well beyond the traditional social activism program. While social activists may endorse independent boards and shareholder voice to the extent that institutional investors are likely to promote stakeholder interests within the firm's board, it remains puzzling that they advocate pro-takeover reforms of corporate charters. Our paper proposes an explanation for this latter fact.