



## WITH GREATER POWER COMES GREATER RESPONSIBILITY? TAKEOVER PROTECTION AND CORPORATE ATTENTION TO STAKEHOLDERS

ALEKSANDRA KACPERCZYK\*

Stephen M. Ross School of Business, University of Michigan, Ann Arbor, Michigan, U.S.A.

*Using takeover protection as an indicator of corporate governance, this study examines how an exogenous shift in power from shareholders to managers affects corporate attention to non-shareholding stakeholders. Two competing hypotheses are entertained. The shareholder view predicts that stronger takeover protection will lead to a decrease in corporate attention to shareholders and non-shareholding stakeholders alike, as managers divert resources from shareholders to the pursuit of their private interests. The stakeholder view, in contrast, predicts that stronger takeover protection will increase corporate attention to non-shareholding stakeholders. Because catering to non-shareholding stakeholders contributes to the long-term value of the firm, managers will be more likely to attend to those stakeholders when relieved from short-termism triggered by the threat of hostile takeovers. Using a sample of 878 U.S. firms from 1991 to 2002, the study finds that an exogenous increase in takeover protection leads to higher corporate attention to community and the natural environment, but has no impact on corporate attention to employees, minorities, and customers. Additional analyses show that firms that increase their attention to stakeholders experience an increase in long-term shareholder value. These findings provide additional evidence that relief from short-termism is a likely source of the increase in corporate attention to non-shareholding stakeholders following the increase in takeover protection. Copyright © 2008 John Wiley & Sons, Ltd.*

### INTRODUCTION

In corporate America, where ownership is separated from control, managers have broad discretion over corporate resources (Berle and Means, 1932). Vested with extensive decision-making power, CEOs are constantly subjected to societal calls for expanding their attention beyond equity holders to include ‘... employees, customers, (and) the

general public’ (Kaysen, 1957: 313). For example, computer, chemical, and auto manufacturers have recently been pressured to develop and implement environmentally friendly practices and products. Although CEOs are increasingly responding to the calls for a greater attention to non-shareholding stakeholders (Cortese, 2002), their discretion over how to allocate corporate resources is constrained by governance mechanisms intended to discipline top managers in their pursuit of shareholder value. How does shareholder control over the incumbent management affect the way that the resources of the firm are allocated? Will managers be more inclined to attend to the interests of non-shareholding stakeholders when freed from the constraints of shareholder control?

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Keywords: corporate governance; stakeholder management; short-termism; agency theory; corporate social responsibility; shareholder value

\* Correspondence to: Aleksandra Kacperczyk, Stephen M. Ross School of Business, The University of Michigan, 701 Tappan Street, Ann Arbor, MI 48109-1234, U.S.A.  
E-mail: kacpercz@umich.edu

The present study examines how corporate governance, defined as a set of mechanisms through which shareholders can limit managerial discretion to pursue ends other than shareholder value (Fama, 1980; Fama and Jensen, 1983; Shleifer and Vishny, 1997), shapes corporate attention to stakeholders. Attending to stakeholders represents the efforts of the firm to proactively support the interests of primary non-shareholding stakeholders, such as employees, customers, communities, or the natural environment (Clarkson, 1995; Wood, 1991). How the strength of corporate governance influences firms' attention to stakeholders can be framed within the broader debate about the purpose of the corporation (e.g., Freeman, Wicks, and Parmar, 2004; Sundaram and Inkpen, 2004).

Two dominant perspectives shed light on the purpose of the firm. The shareholder view posits that firms create value for society by maximizing shareholder wealth (Fama and Jensen, 1983; Jensen and Meckling, 1976). Corporations either bear no direct responsibility toward non-shareholding stakeholders, given that freely elected governments are the only legitimate actors to redress social problems (Friedman, 1970), or fulfill their duty implicitly, by maximizing shareholder value to benefit all other stakeholders (Jensen, 2002). The stakeholder model, in contrast, contends that no one stakeholder, defined as 'any group or individual who can affect or is affected by the achievement of an organization's purpose' (Freeman, 1984: 53), has a *prima facie* priority over other groups, and that corporations must balance the interests of all stakeholders (Donaldson and Preston, 1995; Freeman, 1984; Freeman, Harrison, and Wicks, 2007a; Hill and Jones, 1992; Jones, 1995; Post, Preston, and Sachs, 2002). While each perspective has inspired a separate stream of research on the purpose of the firm, this study suggests that a joint consideration of the insights derived from each view can enhance the understanding of how governance affects corporate attention to non-shareholding stakeholders.

Although informative, previous studies have been largely limited in their conclusions about the influence of governance on corporate attention to stakeholders. First, they have taken into consideration a number of governance mechanisms, such as insider ownership (Atkinson and Galaskiewicz, 1988; Coffey and Wang, 1998; Galaskiewicz, 1997; Jensen and Murphy, 1990; Johnson and Greening, 1999; Kosnik, 1990; Zahra, Oviatt,

and Minyard, 1993), institutional ownership (Coffey and Wang, 1998; Galaskiewicz, 1997; Johnson and Greening, 1999), and outside director representation on the board (Johnson and Greening, 1999; Wang and Coffey, 1992). Those mechanisms, however, are inadequate proxies for the balance between managerial decision-making power and shareholder control. For example, CEO ownership amounts to less than 5 percent in more than 90 percent of U.S. corporations (Ofek and Yermack, 2000), outside ownership is often dispersed (Berle and Means, 1932), and corporate boards, even ones dominated by outsiders, are frequently ineffective in disciplining the incumbent CEOs (Westphal, 1999). Given that the discrete governance mechanisms considered in prior studies do not fully reflect the extent of shareholder influence on managerial control over corporate resources, the theoretical implications of the existing findings remain unclear.

Previous studies have further documented mostly empirical associations between governance and corporate attention to non-shareholding stakeholders (e.g., Coffey and Wang, 1998; Johnson and Greening, 1999), and have fallen short of establishing causality. Though useful in shedding new light on the relation between governance and corporate attention to stakeholders, associations documented in prior research are subject to the problem of reverse causality. For example, a positive relation between corporate attention to stakeholders and insider ownership (e.g., Zahra *et al.*, 1993) may either indicate that managers with higher equity holdings are more inclined to attend to the interests of stakeholders, or that insiders are more likely to acquire higher stakes in stakeholder-friendly firms. Providing insight into cause and effect, though notoriously difficult, is necessary to understand how governance structures shape corporate attention to stakeholders.

The present study seeks to address the limitations of prior research and to provide an additional step toward understanding the effect of governance on corporate attention to stakeholders by examining how takeover protection affects the way organizations cater to the demands of non-shareholding stakeholders. Takeover protection indicates an array of devices, ranging from firm-specific antitakeover provisions in corporate charters to state antitakeover legislation, which aim to protect the firm from being taken over by a hostile acquirer. These devices reduce the influence

of the takeover market, considered the major disciplinary mechanism to enforce managerial attention to the stock price (Fama, 1980; Jensen and Ruback, 1983). By reducing the threat of hostile takeovers and shielding managers from the involuntary turnover that typically follows a change in control (Easterbrook and Fischel, 1981; Walsh and Seward, 1990), takeover protection increases managerial decision-making power and control over firms' resources.

Examining the relation between takeover protection and corporate attention to stakeholders provides an excellent context in which to evaluate the purpose of the firm through the lenses of the shareholder and stakeholder models. Hostile takeovers have led to a confrontation of the two coexisting ways to conceptualize the purpose of the public corporation, exposing the fundamental tension inherent in our understanding of the theory of the firm (Allen, 1992). In the context of hostile takeovers, the two views generate conflicting predictions in regard to how managers should allocate corporate resources among the different stakeholders of the firm. The shareholder view predicts that corporate attention to stakeholders decreases with stronger takeover protection. Because the takeover market disciplines otherwise opportunistic managers (Jensen and Ruback, 1983), takeover protection facilitates managerial self-dealing and deviation from the goal to maximize shareholder value. As managers engage in self-serving activities, shareholder value declines (e.g., Karpoff and Malatesta, 1989; Mahoney and Mahoney, 1993; Pound, 1987) reducing the amount of resources available to cater to the interests of non-shareholding stakeholders (Jensen, 2002). In contrast, the stakeholder model predicts that managers will be more inclined to attend to non-shareholding stakeholders when protected from takeover threats. Because CEOs focus on short-term horizons when threatened by a hostile takeover, they will refrain from catering to non-shareholding stakeholders, an investment conducive to the creation of long-term shareholder value (e.g., Shleifer and Summers, 1988; Stein, 1988).

The present study focuses on the enhancement of the Delaware takeover protection as an empirical setting to understand how protection from hostile takeovers impacts corporate attention to stakeholders. Delaware-incorporated firms experienced greater immunity to hostile takeovers when

several court decisions jointly weakened the traditionally takeover-friendly regime in the mid-1990s. The shift in the Delaware takeover regime provides an ideal setting to study the effect of takeover protection on corporate attention to stakeholders, because Delaware court decisions proxy for a shift in power from shareholders to managers. While firm-specific governance measures, such as insider ownership, adoption of poison pills, classified boards, and dual voting rights are endogenously determined by the firm, the change in legal takeover protection is an exogenous shock that affects all firms incorporated in the state of jurisdiction. Therefore, the joint effect of Delaware court cases represents a unique natural experiment that helps mitigate endogeneity concerns pertinent to governance measures used in prior research.

## THEORY AND HYPOTHESES

### The purpose of the firm: shareholder and stakeholder paradigms

Two theoretical paradigms—the shareholder and stakeholder models—are most relevant to explaining how corporations attend to the interests of their stakeholders. The two models share their understandings of value creation as the process that aims to maximize the welfare of both shareholders and non-shareholding stakeholders, but differ in their prescriptions of how to achieve that goal. The shareholder view posits that managers should focus on maximizing shareholder wealth in order to maximize the sum of the welfare of all stakeholders. The stakeholder view, in contrast, argues that stakeholder welfare is maximized when managers attend directly to all stakeholders without prioritizing the interests of some over the others. Recent interpretations of stakeholder theory further suggest that the shareholder paradigm is subsumed in a broader stakeholder view that admits multiple objective functions (Freeman *et al.*, 2004; Freeman *et al.*, 2007a). Shareholders represent one of the many stakeholders whose interests are supported by the firm to create value for society. Some firms create value in a narrow way by attending only to shareholders, while other firms create value in a broader way by attending to shareholders and non-shareholding stakeholders.

Although catering to one stakeholder benefits other stakeholders when the interests of all stakeholders are aligned, making trade-offs among different stakeholders is necessary when their interests conflict. Conflicting interests are most salient in the context of hostile takeovers that benefit shareholders in the short term via above-market stock price premium (Jarrell, Brickley, and Netter, 1988; Jensen and Ruback, 1983), while decreasing the welfare of other stakeholders (Hirsch, 1987; Shleifer and Summers, 1988). The wave of hostile takeovers in the 1980s generated widespread public concerns regarding the detrimental effects that takeovers had on nonowner stakeholders (Allen, 1992; Millon, 1990), raising the fundamental question about the purpose of the corporation and its rightful claimants. Hence, the present study focuses on the hostile takeover context to understand how managers allocate resources among different stakeholders of the firm when the interests of shareholders and other stakeholders conflict. In the following section, I argue that the shareholder and stakeholder views yield opposite predictions about the impact of hostile takeovers on corporate attention to stakeholders.

### The shareholder paradigm

The shareholder model regards maximization of shareholder value as an objective that ultimately enhances the welfare of all stakeholders. The core argument that creating shareholder value alone benefits all other stakeholders rests on three key assumptions. First, the firm is a nexus of contracts between the corporation as a legal fiction and its stakeholders (Easterbrook and Fischel, 1991; Eisenhardt, 1989; Fama and Jensen, 1983; Jensen and Meckling, 1976). The shareholder view assumes that contracts between the firm and the non-shareholding stakeholders are complete. This implies that all future contingencies can be specified by the contractual relationship with the firm (Tirole, 2001). Consequently, top management has no additional obligation to attend to those stakeholders, as their welfare is already protected by the contracts with the firm. Shareholders, in contrast, bear the residual risk and are thus protected by holding the control rights. Unlike stakeholders, shareholders have an implicit contract with the firm that amounts to their claim on the firm's

residual profits and assets (Easterbrook and Fischel, 1991; Williamson, 1985). Hence, management should attend to shareholders' interests that are not protected otherwise.

The second theoretical assumption underlying the shareholder view suggests that focusing directly on more than one stakeholder requires multitasking and thus impedes the efficient creation of value for all stakeholders. Maximization of shareholder wealth provides a single metric that represents an optimal tool to orient managerial actions and to enhance the welfare of shareholders and non-shareholding stakeholders alike (Jensen, 2002). The third assumption states that the stock market values the corporation's future economic performance in a rational and unbiased fashion (Fama, 1970). If managers pursue goals other than maximizing shareholder value, the stock market will react adversely, subsequently reducing the welfare of all stakeholders.

The shareholder model, as described above, has important implications for understanding how governance affects corporate attention to stakeholders. Though the model leaves the creation of shareholder value in managers' hands, it assumes that the interests of managers and stockholders diverge; satisfying stockholders' claims requires maximization of shareholder value, while satisfying management's claims requires maximization of managers' utility function, through the pursuit of power, remuneration, or social status (Jensen and Meckling, 1976). The takeover market acts as a control device that curbs managers' self-indulgent decision making. If managers deviate from maximizing shareholder wealth, the stock price of their firms will decline, facilitating a hostile takeover that leads to the dismissal of the incumbent management (Manne, 1965).

Although limited empirical evidence exists to support the theoretical claim that the market for corporate control effectively eliminates inefficient CEOs (e.g., Walsh and Ellwood, 1991), hostile takeovers nevertheless discipline incumbent managers in their pursuit of shareholder value, posing a threat to managers' employment and reputation. Takeover protection reduces the disciplining influence of takeover threats, triggering thereby managerial self-dealing. As the stock market reacts adversely to the self-dealing behavior of the incumbent management, the value of firms subject to takeover protection will decline. For example, Karpoff and Malatesta (1989), Mahoney

and Mahoney (1993), Pound (1987), and Ryngaert (1988) find that shareholder value decreases after firms adopt takeover protection devices. Karpoff and Malatesta (1995) also document that Pennsylvania corporations lost \$4 billion in shareholder value after the state passed antitakeover legislation in the 1990s. Shareholder theorists further predict that, as the value of the firm declines, fewer resources will be available to cater to the demands of non-shareholding stakeholders, and those stakeholders will receive a smaller portion of a smaller pie.

In sum, the shareholder model of the firm posits that value for all stakeholders is created most efficiently when managers attend to shareholders' interests, based on the three assumptions: (1) the interests of non-shareholding stakeholders are secured via contracts with the firm; (2) managers are better at managing a single objective function than multiple objective functions; and (3) the stock market reacts adversely to managerial deviation from shareholder value maximization, leading to a decline in the welfare of shareholders and other stakeholders. Corporate governance mechanisms, such as the takeover market, lie at the heart of the process of value maximization, providing an effective instrument to discipline opportunistic managers who deviate from the pursuit of shareholder wealth. By relieving incumbent managers from takeover threats, takeover protection should lead to a decline in corporate attention to shareholders and stakeholders alike.

*Hypothesis 1a: An increase in takeover protection leads to a decrease in corporate attention to stakeholders.*

### The stakeholder paradigm

The stakeholder model provides a competing prediction about the impact of takeover protection on corporate attention to stakeholders. Compared to the shareholder model, stakeholder theory is built around a different set of assumptions. Whereas the shareholder view considers shareholders to be the dominant group whose interests should be supported to maximize the value of the firm, the stakeholder model contends that managers should balance the interests of all stakeholders (Clarkson, 1995; Donaldson and Preston, 1995; Freeman, 1984; Freeman *et al.*, 2007a; Jawahar and McLaughlin 2001; Jones, 1995; Post *et al.*, 2002).

The stakeholder paradigm assumes that the welfare of non-shareholding stakeholders cannot be secured via contracts with the firm. Contracts between the firm and its stakeholders are incomplete, as they cannot anticipate all future contingencies (Hill and Jones, 1992; Shleifer and Summers, 1988). Hence, managers are responsible for catering not only to shareholders, but also to other corporate stakeholders.

Furthermore, unlike the shareholder view, the stakeholder framework does not rely on a single metric to guide managerial decisions. Stakeholder theorists argue that having a single objective enables managers to create value for shareholders at the expense of other stakeholders. For example, firms may fire workers, lower the working standards, pollute the natural environment, and decimate local communities in the pursuit of short-term shareholder goals (Shleifer and Summers, 1988). Maximizing the welfare of all stakeholders requires that managers balance and integrate multiple objectives and multiple stakeholders' interests with no *prima facie* priority of one group of stakeholders over another (Freeman *et al.*, 2004; Freeman *et al.*, 2007a; Jones and Wicks, 1999).<sup>1</sup>

Attending to stakeholders' interests may benefit the firm not only in the short run but also in the long run. Several theoretical views contend that firms that satisfy stakeholders' claims are able to secure intangible resources that enhance firms' ability to create value in the long term. For example, catering to stakeholders has been documented to enhance corporate reputation (Luo and Bhattacharya, 2006; Schnietz and Epstein, 2005; Sen and Bhattacharya, 2001). Resource-based scholars argue that socially complex and difficult to duplicate resources, such as reputation, legitimacy, trust, and knowledge assets, can enhance and sustain competitive advantage in the long run (Barney and Hansen, 1994; Hillman and Keim, 2001; Teece, 1998). Furthermore, Turban and Greening (1997) find that corporate attention to stakeholders increases firms' ability to attract and retain superior human resources that have been shown to provide organizations with a sustained competitive advantage (Lado and Wilson, 1994; Pfeffer, 1994).

<sup>1</sup> Although stakeholder theory eschews *prima facie* priority of one group of stakeholders over another, trade-offs among stakeholders may benefit others in the long run, but this must be decided upon by the effected parties (Freeman Martin, and Parmar, 2007b; Jawahar and McLaughlin, 2001).

Moreover, resource dependence theorists suggest that a stakeholder-friendly orientation enhances long-term corporate success because stakeholders hold the key to resources on which the firm depends for its long-term survival (Carroll, 1989; Pfeffer and Salancik, 1978). The 'instrumental perspective' on stakeholder theory additionally considers corporate attention to stakeholders a 'wealth creating capacity of the corporation' that helps the firm reduce and control costs over the long run (Freeman, 1984: 255). Anecdotal evidence further suggests that firms attend to stakeholders' demands in order to reap long-term benefits. For example, the Whole Foods Market states in its Declaration of Interdependence that 'creating and nurturing this community of stakeholders is critical to the long-term success of our company.'<sup>2</sup>

That the stakeholder-friendly orientation may enhance the value of the firm in the long term has important implications for understanding how takeover protection impacts corporate attention to stakeholders. If corporate attention to stakeholders is associated with long-term returns, managers will be less likely to cater to stakeholders' demands when pressured to pursue short-term goals. Below, I develop a theoretical argument to suggest that the threat of hostile takeovers exerts pressure on managers to focus on short- rather than long-term outcomes. Conversely, managers relieved from takeover threats are more likely to make long-term investments, such as attending to stakeholders' interests.

Several lines of research indicate that CEOs are likely to prioritize short- over long-term goals when threatened by takeovers. For example, studies in organizational and social psychology have documented that individuals tend to refrain from long-term decision making if subjected to a threat. In a series of studies, Gray (1999) finds that people in threat-related negative emotional states favor choices producing immediate outcomes. Staw, Sandelands, and Dutton (1981) suggest that individuals operating under external threat, defined as 'an environmental event that has impending negative or harmful consequences for the entity,' experience restricted information processing, narrow field of attention and a limited repertoire of solutions, all of which increase the probability of

focusing on short-term rather than long-term goals (Staw *et al.*, 1981: 502). Studies of incomplete contracts further argue that takeover threats lead to a breach of trust between the firm and its management; shareholders are unable to offer credible commitments that they will not tender shares to a hostile raider likely to fire the incumbent management (Shleifer and Summers, 1988). Insecure about their long-term employment, managers will privilege short-term outcomes and refrain from making long-term decisions.

Finally, the myopic market view indicates that managers refrain from long-term investments because the stock market consistently undervalues long-term outcomes (e.g., Charkham, 1994; Sykes, 1994). Benefits that accrue to the firm in the long run are more difficult to evaluate by shareholders, because they are associated with greater uncertainty and information asymmetry (Froot, Scharstein, and Stein, 1992; Laverty, 1996). The threat of hostile takeovers forces otherwise forward-looking managers to prioritize short-term profits that boost the current share price in order to avoid undervaluation of the firm's stock by the market, and to prevent the purchase of the firm on the cheap by a hostile acquirer (Drucker, 1986; Stein, 1988). Hence, when threatened by hostile takeovers, managers will be less likely to attend to stakeholders to eschew a potential undervaluation of their investments.

Together, these lines of research suggest that managers tend to have short-term horizons when faced with takeover threats. Because attending to the interests of non-shareholding stakeholders enhances the long-term value of the firm, top managers will be less inclined to cater to stakeholders under a takeover threat. Conversely, takeover protection will shift managers' focus from short- to long-term outcomes, resulting in higher managerial attention to stakeholders. Integrating the above arguments leads to the following hypothesis:

*Hypothesis 1b: An increase in takeover protection leads to an increase in corporate attention to stakeholders.*

### **Attention to stakeholders: a long-term investment, or a form of managerial self-dealing?**

Whereas stakeholder theory predicts that takeover protection should increase corporate attention to

<sup>2</sup> The Whole Foods Market Declaration of Interdependence can be found at <http://www.wholefoodsmarket.com/company/declaration.html> (accessed 14 July 2006).

stakeholders by setting managers free to invest in the long term, an alternative explanation would suggest that CEOs attend to stakeholders to derive private benefits, and will be more inclined to pursue such goals when shielded from takeover threats. Agency theorists regard managerial attention to non-shareholding stakeholders as a self-motivated managerial perquisite that advances managers' private goals while draining corporate resources. Managers attend to stakeholders to garner private benefits, such as *friendship, love, and respect* (Jensen and Meckling, 1976), to enhance social status, and to contribute to personal prestige, social standing in the community, and upward social mobility in local elite circles (Atkinson and Galaskiewicz, 1988; Galaskiewicz, 1985; 1997). Attention to stakeholders enables 'self-interested managers... to pursue their own interests at the expense of society and the firm's financial claimants. It allows managers and directors to invest in their favorite projects that destroy firm-value whatever they are (the environment, art, cities, medical research) without having to justify the value destruction (Jensen, 2002: 242). Agency theory further predicts that managerial self-dealing arises when governance is too weak to limit the use of corporate assets by managers (Jensen and Meckling, 1976). Hence, stronger takeover protection should lead to a greater managerial attention to stakeholders.

This study is an attempt to tease out two mechanisms—*relief from short-termism* derived from stakeholder theory, and *managerial self-dealing* derived from the agency view. To that end, I examine the impact of takeover protection on long-term shareholder value. Relief from short-termism and self-dealing are a source of opposite predictions in regard to the effect of corporate attention to stakeholders on shareholder value. If relief from short-termism accounts for an increase in corporate attention to stakeholders under stronger takeover protection, long-term shareholder value should increase, as the stock market incorporates the value of previously undervalued investments. This leads to the following hypothesis:

*Hypothesis 2a: Firms that increase their attention to stakeholders following an increase in takeover protection will have higher long-term stock market value than firms that do not increase their attention to stakeholders.*

In contrast, agency theory predicts that managerial self-dealing and perquisite consumption increase agency costs (Jensen and Meckling, 1976), leading to a decline in shareholder value (Jensen and Meckling, 1976; Shleifer and Vishny, 1997). For example, Yermack (2006) finds that personal use of a company's aircraft by the CEO affects adversely its stock value. If self-dealing is the mechanism underlying the relation between takeover protection and corporate attention to stakeholders, the future stock market value should decline for firms that increase their attention to non-shareholding stakeholders under stronger takeover protection.

*Hypothesis 2b: Firms that increase their attention to stakeholders following an increase in takeover protection will have lower long-term stock market value than firms that do not increase their attention to stakeholders.*

## METHODS

### Empirical background

Prior empirical attempts to study the effect of governance and corporate attention to stakeholders have been plagued by concerns about endogeneity. Specifically, the relation between governance and corporate attention to stakeholders is subject to the problem of reverse causality—the relation may be significant not because governance impacts firms' attention to stakeholders' demands, but because firms' attention to stakeholders shapes the quality and structure of their governance mechanisms. If not addressed, endogeneity may pose methodological and conceptual challenges. For example, endogenous relations may bias coefficients by distorting their magnitude or by showing a significant relation when none exist (Wooldridge, 2001). Moreover, inferring the direction of causality and establishing causal mechanisms can be conceptually and methodologically difficult when reverse causality is present.

Prior studies have been limited in their attempts to reduce endogeneity bias. Though informative, those studies have focused largely on endogenous governance measures—board composition, insider ownership, or executive compensation (e.g., Coffey and Wang, 1998; Deckop, Merriman, and Gupta, 2006; Johnson and Greening, 1999; Zahra

*et al.*, 1993)—that pose a challenge for interpreting the findings. For example, insider ownership may increase corporate attention to stakeholders, because managers with higher equity holdings have more power vis-à-vis outside shareholders and are more likely to use their discretion to buy off stakeholders' support (e.g., Zahra *et al.*, 1993). However, insiders may also increase their ownership in more stakeholder-friendly firms, expecting those firms to perform better in the long run. In another example, outside board representation increases firms' attention to stakeholders because outside directors are more inclined to recognize and advance the interests of different non-shareholding constituencies (e.g., Johnson and Greening, 1999). Yet an alternative explanation would suggest that stakeholder-friendly firms are more likely to appoint outside directors to legitimize their pro-stakeholder orientation.

This study seeks to overcome the limitations of prior research by using a natural experiment that can effectively mitigate endogeneity bias (Wooldridge, 2001). Specifically, I focus on several court decisions in the mid-1990s that reduced the threat of hostile takeovers in Delaware. The impact of the Delaware change in takeover protection represents an exogenous shock to firms incorporated in that state after 1996. Moreover, Delaware provides an ideal empirical setting because half of all publicly traded companies, and even a greater share of the large publicly traded companies, are incorporated in Delaware (Romano, 1993). Regardless of the location of their physical plants, all Delaware-based firms experienced stronger legal protection from hostile takeovers when several decisions made by the Delaware court jointly reduced takeover threats (Subramanian, 2002).<sup>3</sup>

<sup>3</sup> The takeover-friendly Delaware regime began to experience a gradual change beginning in 1985, when the courts upheld the poison pill in the case of *Moran v. Household International, Inc.* (500 A. 2d 1346 [Del. 1985]), and in 1989 when the case of *Paramount Communications, Inc. v. Time-Warner* (571 A.2d 1140 [Del. 1989]) allowed Warner Brothers to retain its poison pill in the face of a hostile takeover. However, these two events provided a mild protection against hostile takeovers—the legislation, which upheld the poison pill, contained caveats as to the extent of the poison pill application. For example, *Moran v. Household International* (1985) stated that targets did not have 'unfettered discretion' to use poison pills (500 A. 2d 1346 [Del. 1985]: 1355), and the *Time-Warner* (1989) case was a far from clear pill decision that became extended only in the course of takeover contests in the mid-1990s (Subramanian, 2004).

Three hostile takeover contests, together known as the YWC trilogy (Younkers, Wallace, and Circon)—*Carson Pirie Scott & Co. v. Younkers* (1994), *Moore v. Wallace Computer* (1995), and *U.S. Surgical v. Circon* (1996)—conferred stronger immunity to takeover attempts on firms that had already adopted internal takeover defenses. Specifically, the court cases extended the poison pill—a takeover defense that enables shareholders to purchase shares at a discount to the current market price to dilute the equity ownership of the hostile party—to firms with staggered board provisions that delay gaining control of the board by the hostile raider and allow only a fraction of directors to stand for election in a given year (Daines, 2001; Subramanian, 2002; 2004). Because these three takeover defenses work most effectively in conjunction, they enabled Delaware-incorporated firms with staggered boards to implement a poison pill defense, even when the bidder had already won the first proxy contest (Bebchuk, Coates, and Subramanian, 2002). Target firms could now keep their poison pills in place and use the 'just-say-no defense' against would-be acquirers, regardless of the market premiums these acquirers were willing to pay to shareholders (Abelson, 1996).<sup>4</sup>

Although the change in the Delaware takeover regime has numerous advantages as an empirical setting in which to examine the impact of takeover protection on corporate attention to stakeholders, its relevance may be challenged by the claim that hostile takeover bids occurred rarely in the 1990s. Much research indicates that by the 1990s, hostile takeovers became 'friendly deals,' leading the takeover era of the 1980s' to an end (Davis and Thompson, 1994; Jensen, 2000). I argue that, though less frequent, hostile takeovers nevertheless posed a substantial threat to incumbent managers in the 1990s. For example, Comment and Schwert (1995) suggest that the decreased number of actual deals does not provide sufficient basis to conclude that managers were less threatened by hostile takeovers in the 1990s compared to the 1980s. Contrary to a popular belief about a

<sup>4</sup> The magnitude of the impact of the legal change in the Delaware takeover regime has been broadly documented in legal and financial research. For example, Delaware court decisions decreased employee ownership shares and managerial holdings, and led to a decline in the 'value-gap' between companies incorporated inside and outside of Delaware (Daines, 2001; Subramanian 2002; 2004).



clear dichotomization between friendly and hostile takeovers, most deals made in the 1990s were indistinguishable in economic terms, except that hostile transactions involved publicity as part of the bargaining process (Schwert, 2000). Anecdotal evidence further shows a continued influence of takeover threats on top managers in the 1990s. For example, the founders and managers of Google Inc. justified their decision to retain the majority of the voting rights by evoking the necessity to shield the firm from a hostile takeover. Together, the existing studies and anecdotal evidence suggest that hostile takeovers remained a threat to incumbent managers in the 1990s.

### Data and sample

The study uses the Kinder, Lydenberg, Domini & Co. (KLD) data to measure corporate attention to stakeholders. KLD offers multidimensional measures of corporate attention to stakeholders (Hillman and Keim, 2001) that have been extensively used by researchers and practitioners alike (Berman *et al.*, 1999; Deckop *et al.*, 2006; Graves and Waddock, 1994). KLD is a social choice investment advisory firm that relies on independent rating experts to assess how well companies address the demands of their stakeholders based on multiple data sources including annual questionnaires sent to company's investor relations office, firms' financial statements, annual and quarterly reports, general press releases, government surveys, and academic journal publications. The KLD index compiles annual ratings of 650 publicly traded U.S. firms: 500 are part of the Standard & Poor's (S&P) 500 index, and 150 additional firms are included in the Domini 400 Social Index (DSI).<sup>5</sup> This study uses data collected for the period between 1991 and 2002. The final sample represents an unbalanced panel of 878 firms, including a treatment group of 221 Delaware-incorporated firms with staggered boards and a

control group of 657 companies with no staggered board, or incorporated outside Delaware.

### Dependent variables

KLD rates companies on a range of dimensions that reflect how well they cater to community, corporate governance, diversity (to proxy for minorities), the natural environment, human rights, product quality (to proxy for customers), and whether firms' operations are related to alcohol, gambling, firearms, nuclear power, and military contracting. For each dimension, strengths and concerns are measured to evaluate positive and negative aspects of corporate action toward stakeholders. I focus on five KLD dimensions consistently reported between 1991 and 2002: community, minorities, employees, the natural environment, and customers. These dimensions have been selected because they reflect corporate attention to primary stakeholders that impact firms' survival (Clarkson, 1995; Freeman, 1984) and exert considerable influence on corporate strategy (Prahalad and Hamel, 1994).

#### *Corporate attention to stakeholders*

The main dependent variable measures the overall corporate attention to stakeholders and is constructed by aggregating the strengths across the five selected dimensions to obtain a score of total strengths.<sup>6</sup> Because 53 percent of the scores take the value of 0 or 1, I use a binary dependent variable equal to 1 if the firm has been rated as having at least one strength across the five dimensions considered, and 0 otherwise. For robustness, I use a count dependent variable equal to the number of total strengths and obtain even stronger results (see Appendix, Table A1).

<sup>5</sup> The DSI is constructed based on the following rules: it includes 250 S&P 500 companies, 100 non-S&P 500 companies chosen for sector diversification and market capitalization, and 50 additional companies with exemplary social and environmental records. Companies may be removed from the DSI due to corporate actions, violation of exclusionary screens, or poor social or environmental performance. Companies involved in alcohol, tobacco, firearms, gambling, nuclear power, and military weapons are ineligible for inclusion in the DSI; however, such companies may be included in the sample through the S&P 500 index.

<sup>6</sup> Prior studies have generally constructed a composite indicator of corporate attention to stakeholders by subtracting the concerns from the strengths. However, recent work has suggested this specification to be methodologically questionable. Because KLD's strengths and concerns lack convergent validity, using them in conjunction fails to provide valid measures of corporate attention to stakeholders (Johnson-Cramer, 2004; Mattingly and Berman, 2006). Hence, this study uses aggregated strengths rather than the difference between total strengths and concerns as an indicator of corporate attention to stakeholders. For robustness, I calculate a net score for each dimension by subtracting total concerns from total strengths and summing the net scores from each dimension. I find similar results.

*Corporate attention across different stakeholders*

I use five additional dependent variables, each measuring corporate attention to a different stakeholder. Most prior studies have used the aggregate KLD measure, with a few notable exceptions (e.g., Berman *et al.*, 1999; Hillman and Keim, 2001; Johnson and Greening, 1999). However, more research is needed to understand how corporations attend to different stakeholders (Hillman and Keim, 2001). Thus, the study additionally examines the effect of takeover protection on each of the five stakeholders. To that end, I disaggregate the measure of the overall corporate attention to stakeholders. I use a binary dependent variable equal to 1 if the score is greater or equal to 1, and 0 otherwise, for each stakeholder. For robustness, I use a count variable to measure corporate attention to each stakeholder. I use a Poisson model to estimate the regression models and find qualitatively similar results (see Appendix, Table A1).

*Shareholder value*

The market-to-book ratio (M/B) is used to calculate shareholder value in the short term (one year into the future:  $MB_{t+1}$ ) and in the long term (two and three years into the future:  $MB_{t+2}$ , and  $MB_{t+3}$ ). Technically, M/B is measured as the sum of market value of equity and book value of debt divided by the book value of assets. Intuitively, the measure equals the ratio of the firm's market value (equity plus debt) to the replacement cost of its physical assets (book value of assets), and is high when the firm has valuable intangible assets, such as managerial skill, monopoly power, goodwill, or a stock of patents, in addition to physical capital (Morck, Shleifer, and Vishny, 1988). M/B is commonly used to approximate Tobin's Q (Lindenberg and Ross, 1981). Though Q is often considered a noisy signal of how well managers serve shareholders' claims, it is a forward-looking market-based measure of financial performance that indicates the market expectation of the present value of future profits that the company will generate from the current assets in place.

**Explanatory variables***Takeover protection*

The Delaware court decisions reduced the threat of hostile takeovers for firms with staggered boards

and incorporated in Delaware after 1996. Thus, to measure the threat of hostile takeovers, I use a binary variable equal to 1 if (1) year is greater or equal to 1996, (2) the company has a staggered board, and (3) the company is incorporated in Delaware; and 0 otherwise. Consistent with prior literature, 1996 indicates the watershed year when Delaware-based companies experienced enhanced legal protection from takeovers (Subramanian, 2004). I check for the sensitivity of this date by examining trends in corporate attention to stakeholders prior to 1996. To this end, I construct a dummy variable (*pre-change*) equal to 1 if the company has a staggered board and is incorporated in Delaware two or three years before the change in the Delaware takeover regime (in 1993 or in 1994); and 0 otherwise. The state of incorporation and the presence of staggered board provisions are determined via Gompers, Ishii, and Metrick (2003) measures constructed using the Investor Responsibility Research Center (IRRC) data on corporate governance. I find no significant relation between the *pre-change* variable and corporate attention to stakeholders, which provides further evidence that the validation of the poison pill came into effect in the mid-1990s (see Appendix, Table A2).

**Control variables**

Given that the main independent variable—takeover protection—represents an interaction of three variables, those variables must be separately included as controls in the regression models. I include the *staggered board* variable, equal to 1 if a firm has a staggered board and 0 otherwise, to control for the presence of a staggered board provision in the corporate charter. The *Delaware incorporation* variable, equal to 1 if the firm is incorporated in Delaware and 0 otherwise, is included to control for Delaware incorporation. The *post 96* variable, equal to 1 if the observation year is greater or equal to 1996 and 0 otherwise, is included to control for economy-wide events occurring in and after 1996. The three binary variables are observed annually.

Furthermore, pension fund and insider ownership are included in the regression models to control for alternative governance mechanisms. Since pension funds hold a relatively large proportion of the firms' stock, they are better equipped to effectively monitor incumbent management (Shleifer and Vishny, 1986). Hence, as managers become

more accountable to shareholders, they may be less inclined to attend to social issues that deviate from shareholder objectives. In contrast, because pension funds focus on long-term performance of the companies they own (Pound, 1988), firms with higher concentration of ownership by pension funds should experience more pressure to attend to non-shareholding stakeholders. I measure pension fund ownership as the percentage of stocks owned by the pension fund with the largest share.<sup>7</sup> Shareholders of pension funds are identified using a list of pension fund names and their corresponding institutional manager numbers (Dittmar and Mahrt-Smith, 2007). This list is subsequently matched with annual institutional ownership data provided by Thomson Financial.

Insider ownership may motivate managers to maximize shareholder value at the expense of other stakeholders, as it aligns the incentives of both shareholders and managers. Conversely, because insider ownership shields incumbent managers from the takeover market, executives with equity holdings should increase their support for diverse stakeholders in pursuit of long-term goals. I measure insider ownership as the sum of shares in the company held by corporate insiders divided by the total number of shares outstanding. Corporate insiders include those having access to nonpublic, material, inside information. Insiders are identifiable because they are required to file Securities and Exchange Commission forms (3rd, 4th, and 5th) when trading their company's stock. Data on insider ownership report the number of shares held by corporate insiders, excluding stock options, and are drawn from Thomson Financial Insider holdings.

I further control for other forms of takeover protection, such as firm-specific takeover defenses. Intuitively, if firms are already protected from hostile takeovers by firm-specific antitakeover measures, I should find no significant relation between the Delaware takeover protection and corporate attention to stakeholders. To account for those alternative takeover defenses, I include the Governance Index as a control variable (Gompers *et al.*, 2003). The Governance Index counts the number of antitakeover measures falling broadly

into five distinct groups: tactics for delaying hostile bidders (Delay), voting rights (Voting), director/officer protection (Protection), other takeover defenses (Other), and state laws (State). Higher values of the index indicate greater corporate immunity to takeover threats.

Finally, I control for corporate characteristics—book leverage, performance, and size—that may influence corporate attention to stakeholders (Waddock and Graves, 1997). Book leverage is measured annually as the total book value of debt divided by the book value of total assets. Size is measured annually as the natural logarithm of sales. Performance is measured annually as the return on assets indicated by the ratio of earnings before interest, taxes, depreciation, and amortization (EBITDA) to total assets. All measures are drawn from Compustat.

### Shareholder vs. stakeholder models: model specification

I examine the effect of takeover protection on corporate attention to stakeholders with the difference-in-differences (DD) method, widely used to assess the influence of policy and law changes (Bertrand and Mullainathan, 2003). The DD method is similar to the matched-sample (MS) method—it compares the treatment group (firms affected by the law) to the control group (firms not affected by the law), while holding other variables constant. However, because the MS approach allows for matching only on a limited number of firm characteristics (e.g., size), it may lead to a sample selection bias, as the sample size becomes artificially and arbitrarily restricted. The DD method, in contrast, allows for a comparison across all firms' characteristics and the use of the entire universe of firms both in the treatment and control groups, reducing a coefficient bias that may arise from a nonrandom sample selection. The DD approach can be intuitively understood as a comparison of corporate attention to stakeholders between Delaware-incorporated firms with staggered boards (the treatment sample) before and after 1996, and firms without staggered boards, or incorporated outside of Delaware (the control sample) before and after 1996. Thus, I compare the difference in corporate attention to stakeholders of the treatment sample before and after 1996 to the difference in attention to stakeholders of the control sample before and after 1996. The difference in these differences

<sup>7</sup> For robustness, I use the sum of holdings of all pension funds and find similar results.

serves as the estimate of the effect of Delaware court decisions on corporate attention to stakeholders.

The following random effects logistic regression model is estimated to examine the effect of takeover protection on corporate attention to stakeholders:

$$\Pr(y_{iskt} = 1) = F(\alpha_t + \beta_i + \gamma D_t + \delta PO_{iskt} + \lambda GIM_{iskt} + \mu IO_{iskt} + \eta X_{iskt} + \varepsilon_{iskt})$$

where  $i$  indexes firms,  $s$  indexes the state of incorporation,  $k$  indexes the state of location,  $t$  indexes time,  $y_{iskt}$  is the dependent variable equal to 1 if the sum of the strengths that measure attention toward stakeholders is greater than 0, and 0 otherwise. The main explanatory variable  $D_t$  equals 1 if a firm is incorporated in Delaware, has a staggered board, and  $t$  is greater or equal to 1996.  $PO_{iskt}$  measures the percentage of stock ownership of the pension fund that has the largest share in the firm,  $IO_{iskt}$  measures the sum of insider equity holdings, and  $GIM_{iskt}$  is the Governance Index (Gompers *et al.*, 2003) that measures the number of other takeover protections for firm  $i$ . The vector of control variables,  $X_{iskt}$ , includes size, performance, leverage, and the three binary variables that measure separately whether a firm is incorporated in Delaware, the year of incorporation is greater or equal to 1996, and whether the firm has a staggered board provision in its charter.

To address concerns related to unobserved heterogeneity and autocorrelation, firm-random effects ( $\beta_i$ ) and time-fixed effects ( $\alpha_t$ ) are used.<sup>8</sup> Moreover, the state of location and the state of incorporation tend to differ, reducing the concern that a change in economic conditions in the state of location is a third factor that accounts for both the passage of the law and the change in corporate attention to stakeholders. Finding a positive sign

<sup>8</sup> Due to a nonlinear nature of the logistic function, firm-fixed effects would lead to an exclusion from the sample of those firms for which KLD ratings are time invariant. Because such exclusion would produce biased estimates, firm-fixed effects cannot be used. Instead, I use firm-random effects to control for unobserved heterogeneity, consistent with the results of the Hausman test (Hausman, 1978). For robustness, I replace the binary variable for each stakeholder, with an alternative specification of the dependent variable—equal to  $\log(1 + \text{sum}(\text{strengths}))$ . This count variable, commonly used in industrial organization and strategy research (e.g., Kortum and Lerner, 2000), indicates the sum of strengths. I estimate OLS regressions with firm-fixed effects, and find qualitatively similar results.

of coefficient estimate of the Delaware takeover protection would provide support for the hypothesis derived from stakeholder theory (Hypothesis 1b), suggesting that a Delaware-incorporated firm with a staggered board after 1996 is  $\gamma$  times more likely to attend to its stakeholders, as compared to its counterpart in the control sample. Conversely, finding a negative coefficient estimate would provide support for the hypothesis derived from the shareholder view (Hypothesis 1a), suggesting that a Delaware-incorporated firm with a staggered board after 1996 is  $\gamma$  times less likely to attend to its stakeholders, as compared to its counterpart in the control sample.

### Attention to stakeholders: a long-term investment, or a form of managerial self-dealing?

This study further attempts to tease out relief from short-termism and managerial self-dealing. To that end, I examine the joint effect of the takeover protection and corporate attention to stakeholders on shareholder value, measured by the market-to-book ratio. I use ordinary least squares (OLS) regression models with firm- and year-fixed effects. A positive coefficient on the interaction term will provide support for relief from short-termism, implying that long-term shareholder value increases for firms more likely to attend to stakeholders (Hypothesis 2a). Conversely, a negative coefficient on the interaction term will provide support for the self-dealing hypothesis, which predicts a decrease in shareholder value for firms that increase their attention to stakeholders under stronger takeover protection (Hypothesis 2b).

## RESULTS

### Descriptive statistics

Table 1 shows descriptive statistics (Panel A) and correlations (Panel B) for the dependent variables and the explanatory variables. Overall, 70 percent of firms in the KLD sample have been rated as paying attention to stakeholders. Twenty-six percent have been rated as paying attention to community, 39 percent to minorities, 22 percent to the natural environment, 34 percent to employees, and 15 percent to customers. Fifty-five percent of firms are

Table 1. Panel A. Descriptive statistics

| Variables                  | Mean   | SD      | Min    | Max      |
|----------------------------|--------|---------|--------|----------|
| Stakeholders               | 0.698  | 0.459   | 0      | 1        |
| Community                  | 0.264  | 0.441   | 0      | 1        |
| Minorities                 | 0.388  | 0.487   | 0      | 1        |
| Environment                | 0.217  | 0.413   | 0      | 1        |
| Employees                  | 0.341  | 0.474   | 0      | 1        |
| Customers                  | 0.154  | 0.361   | 0      | 1        |
| Takeover protection        | 0.150  | 0.357   | 0      | 1        |
| Post 96                    | 0.664  | 0.472   | 0      | 1        |
| Staggered board            | 0.607  | 0.488   | 0      | 1        |
| Delaware incorporation     | 0.552  | 0.497   | 0      | 1        |
| Governance Index           | 9.685  | 2.681   | 1      | 16       |
| Leverage                   | 0.247  | 0.180   | 0      | 0.8      |
| Performance (ROA)          | 0.143  | 0.105   | -1.184 | 1.070    |
| Size (Sales)               | 7378.0 | 15451.2 | 0.0    | 245308.0 |
| Pension fund ownership     | 1.667  | 2.700   | 0.000  | 41.843   |
| Insider ownership          | 0.366  | 0.482   | 0.000  | 1.000    |
| Shareholder value (M/B)    | 1.680  | 1.816   | 0.016  | 38.9     |
| Total current compensation | 1628.2 | 1542.5  | 0.0    | 43511.5  |

incorporated in Delaware, 60 percent have staggered boards, 66 percent are observed after 1996, and 15 percent satisfy all three criteria. A firm has, on average, a leverage of 0.25, and return on assets of 14.3 percent. The pension fund with the largest share owns 1.67 percent of the firm's stock on average, and the sum of the stock ownership of all insiders equals on average 36.7 percent. The main dependent (*stakeholders*) and independent (*takeover protection*) variables are positively correlated. Except for leverage and the Governance Index, all control variables correlate positively with the dependent variable.

### Shareholder vs. stakeholder models: multivariate analysis

Table 2 presents the results estimated using firm-random effects regressions to test the hypothesized relation between takeover protection and corporate attention to stakeholders. Model 1 shows the estimates for the effect of takeover protection on the overall corporate attention to stakeholders, while Models 2–6 present estimates for the effect of takeover protection on corporate attention across different stakeholders. In each model, the coefficients on the *Takeover protection* variable discriminate the hypothesized negative (Hypothesis 1a) vs. positive (Hypothesis 1b) effect of takeover protection on corporate attention to stakeholders. Takeover protection leads to an increase

in the overall corporate attention to stakeholders (Model 1), corporate attention to community (Model 2), and to the natural environment (Model 4), but it has no effect on corporate attention to minorities (Model 3), employees (Model 5), and customers (Model 6). In the subsequent section, I conduct additional analyses to further understand the mechanisms underlying these findings. Overall, the results presented in Table 2 provide support for the stakeholder (Hypothesis 1b) vs. shareholder paradigm (Hypothesis 1a), showing that companies with staggered boards and incorporated in Delaware are more likely to increase their attention to stakeholders' demands following an increase in takeover protection, as compared to the control group of firms. A negative effect of takeover protection on corporate attention to stakeholders, as predicted by the shareholder view, does not find support in any of the regression models. All results are robust to the use of a count measure as an alternative specification of the dependent variable (Table A1).

Table 2 also shows that pension fund ownership is positively related to corporate attention to stakeholders, in line with the results from previous studies (Graves and Waddock, 1994; Johnson and Greening, 1999). Due to a large portfolio ownership, pension funds are less likely to divest stocks without affecting the stock price (Pound, 1988) and they may, therefore, take greater interest in

Table 1. Panel B. Correlations of the main variables

| Variables                     | 1         | 2         | 3         | 4         | 5        | 6         | 7         | 8         | 9     |
|-------------------------------|-----------|-----------|-----------|-----------|----------|-----------|-----------|-----------|-------|
| 1 Stakeholders                | 0.020**   |           |           |           |          |           |           |           |       |
| 2 Takeover protection         | 0.002     | 0.297***  |           |           |          |           |           |           |       |
| 3 Governance Index            | 0.007     | 0.047***  | 0.108***  |           |          |           |           |           |       |
| 4 Leverage                    | 0.103***  | -0.049*** | 0.014     | -0.095*** |          |           |           |           |       |
| 5 Performance (ROA)           | 0.160***  | -0.0118   | -0.148*** | 0.162***  | -0.034** |           |           |           |       |
| 6 Size (Sales)                | 0.156***  | -0.034**  | -0.112*** | 0.021     | 0.058*** | 0.541***  |           |           |       |
| 7 Pension fund ownership      | -0.062*** | -0.078**  | -0.082*** | -0.156*** | 0.074*** | -0.134*** | -0.122*** |           |       |
| 8 Insider ownership           | 0.091***  | -0.047*** | -0.157*** | -0.344*** | 0.467*** | -0.065*** | 0.212***  | 0.105***  |       |
| 9 Shareholder value (M/B)     | 0.089***  | 0.055***  | -0.029**  | 0.134***  | -0.002   | 0.418***  | 0.351***  | -0.093*** | 0.031 |
| 10 Total current compensation |           |           |           |           |          |           |           |           |       |

firms' returns over a long period of time. Insider ownership exhibits a significant positive association with corporate attention to customers, suggesting that managers with high ownership stakes are more likely to cater to stakeholders. The Governance Index is positively correlated with corporate attention to community. Including the index in the models further strengthens the precision of the coefficient that estimates the effect of the Delaware takeover protection on corporate attention to stakeholders, and shows that the change in the Delaware takeover regime has a significant predictive power above and beyond firm-specific takeover defenses.

Performance is positively associated with the overall attention to stakeholders (Model 1), and more specifically, with firms' attention to minorities (Model 3), employees (Model 5), and customers (Model 6). A negative association is found between performance and corporate attention to the natural environment (Model 4). Broadly, these results are consistent with the line of research that documents a positive relation between attention to stakeholders and financial performance (e.g., Waddock and Graves, 1997). Financial leverage shows a significant negative association with corporate attention to employees and customers, and a positive association with attention to the natural environment. Consistent with Titman (1984), these findings suggest that financially constrained firms concerned with meeting their future obligations are less likely to provide support for employees and to attend to customers. Firm size is positively associated with corporate attention to stakeholders in all models, indicating that larger firms are more likely than smaller firms to cater to stakeholders' interests. Larger firms may take advantage of economies of scale and cater to stakeholders with funds that represent a smaller percentage of their total assets. Larger firms are also more likely to become the target of social activists, policymakers, socially responsible institutional investors, and stakeholders, in general.

**A long-term investment or a form of managerial self-dealing? Multivariate analysis**

I now conduct a test to distinguish between relief from short-termism and self-dealing. Relief from short-termism suggests that those firms that increase their corporate attention to stakeholders

Table 2. Logistic regression results: corporate attention to stakeholders and takeover protection

| Variables              | Stakeholders<br>(1) | Community<br>(2)     | Minorities<br>(3)   | Environment<br>(4)  | Employees<br>(5)    | Customers<br>(6)     |
|------------------------|---------------------|----------------------|---------------------|---------------------|---------------------|----------------------|
| Takeover protection    | 0.507*<br>(0.263)   | 1.402***<br>(0.258)  | 0.421<br>(0.263)    | 1.207***<br>(0.257) | 0.097<br>(0.226)    | 0.336<br>(0.295)     |
| Post 96                | 1.091***<br>(0.312) | -0.404<br>(0.333)    | 1.859***<br>(0.357) | 0.385<br>(0.336)    | 1.230***<br>(0.308) | 0.432<br>(0.390)     |
| Staggered board        | 0.223<br>(0.291)    | -0.244<br>(0.292)    | -0.060<br>(0.284)   | 0.368<br>(0.292)    | 0.144<br>(0.270)    | 0.135<br>(0.304)     |
| Delaware incorporation | -0.650**<br>(0.279) | -1.234***<br>(0.284) | -0.403<br>(0.272)   | -0.689**<br>(0.284) | -0.127<br>(0.263)   | -0.336<br>(0.286)    |
| Governance Index       | 0.039<br>(0.050)    | 0.118**<br>(0.052)   | -0.036<br>(0.048)   | -0.011<br>(0.052)   | -0.076<br>(0.047)   | -0.003<br>(0.053)    |
| Leverage               | -0.577<br>(0.624)   | 0.899<br>(0.637)     | -0.868<br>(0.618)   | 3.149***<br>(0.639) | -1.233**<br>(0.579) | -2.598***<br>(0.715) |
| Performance            | 2.334**<br>(1.100)  | 0.480<br>(1.075)     | 2.241**<br>(1.032)  | -2.246**<br>(1.121) | 1.667*<br>(0.945)   | 2.086*<br>(1.222)    |
| Size                   | 0.649***<br>(0.113) | 1.043***<br>(0.107)  | 0.872***<br>(0.104) | 0.305***<br>(0.100) | 0.597***<br>(0.100) | 0.375***<br>(0.109)  |
| Pension fund ownership | 0.352***<br>(0.077) | 0.184***<br>(0.039)  | 0.255***<br>(0.060) | 0.043<br>(0.029)    | 0.107***<br>(0.039) | 0.128***<br>(0.039)  |
| Insider ownership      | -0.232<br>(0.158)   | -0.126<br>(0.167)    | 0.070<br>(0.156)    | -0.286*<br>(0.172)  | -0.041<br>(0.146)   | 0.456**<br>(0.187)   |
| Observations           | 4538                | 4538                 | 4538                | 4538                | 4538                | 4538                 |
| Number of firms        | 878                 | 878                  | 878                 | 878                 | 878                 | 878                  |
| Log likelihood         | -1627               | -1378                | -1703               | -1330               | -1820               | -989                 |
| Firm-random effects    | Yes                 | Yes                  | Yes                 | Yes                 | Yes                 | Yes                  |
| Time-fixed effects     | Yes                 | Yes                  | Yes                 | Yes                 | Yes                 | Yes                  |

Standard errors in parentheses

All tests two-tailed \* significant at 10%; \*\* significant at 5%; \*\*\* significant at 1%

under stronger takeover protection should experience an increase in long-term shareholder value (Hypothesis 2a) relative to their counterparts that do not change their attention to stakeholders. In contrast, managerial self-dealing suggests that firms that increase their attention to stakeholders when shielded from takeover threats should experience a subsequent decrease in shareholder value (Hypothesis 2b) relative to those firms that do not change their attention to stakeholders. Table 3 (Panel A) shows the results of the firm- and year-fixed effects regressions.

The positive coefficient on the interaction term between takeover protection and corporate attention to stakeholders suggests that those firms which have staggered boards, are incorporated in Delaware after 1996, and that increase their overall attention to stakeholders, experience a subsequent increase in shareholder value one and two years into the future. In contrast, the negative coefficient of takeover protection indicates that firms that do not cater to stakeholders after the increase in takeover protection experience a subsequent

decline in shareholder wealth one year into the future. Together, these findings provide evidence that takeover protection leads to an increase in corporate attention to stakeholders by relieving CEOs from short-termism (Hypothesis 2a). In contrast, the alternative mechanism—managerial self-dealing (Hypothesis 2b)—finds no empirical support.

Because takeover protection leads to an increase in corporate attention toward community and the natural environment, but not toward employees, customers, or minorities, I conduct additional analyses to examine how the change in corporate attention to each stakeholder separately affects future shareholder value. The results (Table 3, Panel B) show that long-term stock market value increases for firms more attentive to community, the natural environment, and minorities. The increase in the long-term (two and three years into the future) stock market value suggests that the value of corporate attention to the above groups may be underappreciated by the stock market. In the current period  $t$ , the market does not entirely understand

Table 3. Panel A. OLS regression results: stock market value, takeover protection, and corporate attention to stakeholders (all stakeholders)

| Variables                         | MBt + 1<br>(1)       | MBt + 2<br>(2)       | MBt + 3<br>(3)       |
|-----------------------------------|----------------------|----------------------|----------------------|
| Takeover protection               | -0.291**<br>(0.131)  | -0.192<br>(0.138)    | 0.017<br>(0.150)     |
| Stakeholders                      | -0.031<br>(0.061)    | -0.003<br>(0.066)    | 0.081<br>(0.072)     |
| Takeover protection* stakeholders | 0.259*<br>(0.139)    | 0.276*<br>(0.147)    | 0.114<br>(0.162)     |
| Post 96                           | 0.310***<br>(0.082)  | -0.327***<br>(0.094) | 0.570***<br>(0.088)  |
| Staggered board                   | -0.203<br>(0.155)    | -0.196<br>(0.176)    | -0.426*<br>(0.220)   |
| Delaware incorporation            | -0.046<br>(0.207)    | -0.493**<br>(0.240)  | -0.980***<br>(0.306) |
| Governance Index                  | -0.020<br>(0.023)    | -0.035<br>(0.025)    | -0.035<br>(0.029)    |
| Leverage                          | -0.858***<br>(0.226) | -0.139<br>(0.251)    | 0.279<br>(0.287)     |
| Performance                       | 4.521***<br>(0.331)  | 2.194***<br>(0.408)  | 0.403<br>(0.482)     |
| Size                              | 0.027<br>(0.056)     | 0.042<br>(0.067)     | 0.176**<br>(0.076)   |
| Observations                      | 3773                 | 3154                 | 2698                 |
| Number of firms                   | 623                  | 462                  | 413                  |
| R-squared                         | 0.14                 | 0.09                 | 0.09                 |
| Firm-fixed effects                | Yes                  | Yes                  | Yes                  |
| Time-fixed effects                | Yes                  | Yes                  | Yes                  |

Standard errors in parentheses

All tests two-tailed \* significant at 10%; \*\* significant at 5%; \*\*\* significant at 1%

the long-term benefits associated with attention to those stakeholders, taking up to three years to incorporate the entire value of such investments into the stock price.

In contrast, Table 3 (Panel C) shows no significant effect on long-term stock market value for companies that increase their attention to employees or customers. This suggests that the market does not significantly undervalue corporate attention to employees and customers because a change in how firms address the demands of those stakeholders is incorporated into the stock price either immediately (for customers), or after one year (for employees).

## DISCUSSION

This study examines how corporate governance affects firms' attention to non-shareholding stakeholders. The results provide support for stakeholder theory, showing that firms are more likely

to attend to stakeholders when shielded from takeover threats. In contrast, the hypothesis derived from the shareholder model, suggesting that corporate attention to stakeholders will decrease with higher takeover protection, finds no empirical support. The study provides additional evidence that relief from short-termism rather than managerial self-dealing underlines the increase in corporate attention to stakeholders. Together, these findings contribute to the long-standing debate about the purpose of the firm—they document the relevance of the stakeholder model for explaining how firms' resources are allocated when the interests of shareholders and stakeholders conflict. Future research could try to understand how managers distribute corporate resources in other types of settings that breach the contracts between shareholders and stakeholders. Recent examples of corporate bankruptcies and the subprime mortgage crisis provide excellent contexts in which to explore the tension between the shareholder and stakeholder conceptions of the firm.



Table 3. Panel B. OLS regression results: stock market value, takeover protection, and corporate attention to stakeholders (institutional stakeholders)

| Variables                           | MBt + 1<br>(1)       | MBt + 2<br>(2)       | MBt + 3<br>(3)       | MBt + 1<br>(4)       | MBt + 2<br>(5)       | MBt + 3<br>(6)       | MBt + 1<br>(7)       | MBt + 2<br>(8)       | MBt + 3<br>(9)       |
|-------------------------------------|----------------------|----------------------|----------------------|----------------------|----------------------|----------------------|----------------------|----------------------|----------------------|
| Takeover protection                 | -0.230***<br>(0.080) | -0.174**<br>(0.086)  | 0.001<br>(0.096)     | -0.195**<br>(0.086)  | -0.131<br>(0.091)    | -0.042<br>(0.100)    | -0.118<br>(0.085)    | -0.090<br>(0.092)    | -0.009<br>(0.102)    |
| Community                           | -0.069<br>(0.066)    | -0.072<br>(0.069)    | 0.018<br>(0.076)     |                      |                      |                      |                      |                      |                      |
| Takeover protection *<br>community  | 0.509***<br>(0.126)  | 0.667***<br>(0.134)  | 0.341**<br>(0.149)   |                      |                      |                      |                      |                      |                      |
| Minorities                          |                      |                      |                      | 0.073<br>(0.061)     | 0.091<br>(0.067)     | 0.162**<br>(0.075)   |                      |                      |                      |
| Takeover protection *<br>minorities |                      |                      |                      | 0.244**<br>(0.112)   | 0.365***<br>(0.123)  | 0.365***<br>(0.140)  |                      |                      |                      |
| Environment                         |                      |                      |                      |                      |                      |                      | 0.005<br>(0.068)     | 0.012<br>(0.071)     | 0.050<br>(0.077)     |
| Takeover protection*<br>environment |                      |                      |                      |                      |                      |                      | 0.077<br>(0.124)     | 0.284**<br>(0.133)   | 0.286*<br>(0.148)    |
| Post 96                             | 0.305***<br>(0.082)  | -0.308***<br>(0.093) | 0.584***<br>(0.088)  | 0.299***<br>(0.082)  | -0.354***<br>(0.095) | 0.568***<br>(0.089)  | 0.302***<br>(0.082)  | -0.325***<br>(0.093) | 0.579***<br>(0.088)  |
| Staggered board                     | -0.209<br>(0.155)    | -0.200<br>(0.176)    | -0.435**<br>(0.220)  | -0.202<br>(0.155)    | -0.196<br>(0.176)    | -0.437**<br>(0.219)  | -0.198<br>(0.156)    | -0.199<br>(0.176)    | -0.440**<br>(0.220)  |
| Delaware incorporation              | -0.012<br>(0.206)    | -0.446*<br>(0.240)   | -0.967***<br>(0.306) | -0.025<br>(0.207)    | -0.492**<br>(0.240)  | -1.009***<br>(0.305) | -0.035<br>(0.207)    | -0.482**<br>(0.240)  | -0.947***<br>(0.306) |
| Governance Index                    | -0.023<br>(0.853***) | -0.038<br>(0.025)    | -0.037<br>(0.029)    | -0.023<br>(0.023)    | -0.037<br>(0.025)    | -0.035<br>(0.029)    | -0.021<br>(0.023)    | -0.033<br>(0.025)    | -0.032<br>(0.029)    |
| Leverage                            | -0.853***<br>(0.226) | -0.128<br>(0.250)    | 0.286<br>(0.287)     | -0.879***<br>(0.226) | -0.155<br>(0.250)    | 0.279<br>(0.286)     | -0.875***<br>(0.227) | -0.152<br>(0.251)    | 0.279<br>(0.287)     |
| Performance                         | 4.509***<br>(0.330)  | 2.189***<br>(0.407)  | 0.418<br>(0.482)     | 4.495***<br>(0.331)  | 2.125***<br>(0.408)  | 0.316<br>(0.481)     | 4.520***<br>(0.331)  | 2.225***<br>(0.409)  | 0.461<br>(0.482)     |
| Size                                | 0.019<br>(0.056)     | 0.028<br>(0.067)     | 0.163**<br>(0.076)   | 0.025<br>(0.056)     | 0.036<br>(0.067)     | 0.165**<br>(0.076)   | 0.026<br>(0.056)     | 0.042<br>(0.067)     | 0.174**<br>(0.076)   |
| Observations                        | 3773                 | 3154                 | 2698                 | 3773                 | 3154                 | 2698                 | 3773                 | 3154                 | 2698                 |
| Number of firms                     | 623                  | 462                  | 413                  | 623                  | 462                  | 413                  | 623                  | 462                  | 413                  |
| R-squared                           | 0.14                 | 0.10                 | 0.09                 | 0.14                 | 0.10                 | 0.10                 | 0.14                 | 0.09                 | 0.09                 |

All tests two-tailed \* significant at 10%; \*\* significant at 5%; \*\*\* significant at 1%

Table 3. Panel C. OLS regression results: stock market value, takeover protection, and corporate attention to stakeholders (technical stakeholders)

| Variables              | MBt + 1<br>(1)       | MBt + 2<br>(2)       | MBt + 3<br>(3)       | MBt + 1<br>(4)       | MBt + 2<br>(5)       | MBt + 3<br>(6)       |
|------------------------|----------------------|----------------------|----------------------|----------------------|----------------------|----------------------|
| Takeover protection    | -0.195**<br>(0.086)  | -0.029<br>(0.093)    | 0.130<br>(0.103)     | -0.109<br>(0.076)    | 0.024<br>(0.080)     | 0.109<br>(0.089)     |
| Employees              | -0.096<br>(0.058)    | -0.058<br>(0.062)    | -0.045<br>(0.069)    |                      |                      |                      |
| Delaware* employees    | -0.097*<br>(0.058)   | -0.061<br>(0.062)    | -0.048<br>(0.069)    |                      |                      |                      |
| Customers              |                      |                      |                      | 0.122<br>(0.079)     | 0.118<br>(0.085)     | -0.022<br>(0.092)    |
| Delaware* customers    |                      |                      |                      | 0.137<br>(0.159)     | -0.003<br>(0.171)    | 0.018<br>(0.193)     |
| Post 96                | 0.317***<br>(0.082)  | -0.307***<br>(0.094) | 0.587***<br>(0.088)  | 0.299***<br>(0.082)  | -0.322***<br>(0.093) | 0.580***<br>(0.088)  |
| Staggered board        | -0.197<br>(0.155)    | -0.191<br>(0.176)    | -0.429*<br>(0.220)   | -0.188<br>(0.155)    | -0.180<br>(0.176)    | -0.426*<br>(0.220)   |
| Delaware incorporation | -0.071<br>(0.207)    | -0.502**<br>(0.241)  | -0.961***<br>(0.307) | -0.034<br>(0.207)    | -0.491**<br>(0.241)  | -0.973***<br>(0.306) |
| Governance Index       | -0.022<br>(0.023)    | -0.037<br>(0.025)    | -0.037<br>(0.029)    | -0.022<br>(0.023)    | -0.037<br>(0.025)    | -0.036<br>(0.029)    |
| Leverage               | -0.858***<br>(0.226) | -0.151<br>(0.251)    | 0.274<br>(0.287)     | -0.880***<br>(0.226) | -0.166<br>(0.251)    | 0.282<br>(0.287)     |
| Performance            | 4.497***<br>(0.331)  | 2.194***<br>(0.409)  | 0.419<br>(0.482)     | 4.511***<br>(0.331)  | 2.179***<br>(0.409)  | 0.419<br>(0.483)     |
| Size                   | 0.022<br>(0.056)     | 0.037<br>(0.067)     | 0.171**<br>(0.076)   | 0.025<br>(0.056)     | 0.039<br>(0.067)     | 0.173**<br>(0.076)   |
| Observations           | 3773                 | 3154                 | 2698                 | 3773                 | 3154                 | 2698                 |
| Number of firms        | 623                  | 462                  | 413                  | 623                  | 462                  | 413                  |
| R-squared              | 0.14                 | 0.09                 | 0.09                 | 0.14                 | 0.09                 | 0.09                 |
| Firm-fixed effects     | Yes                  | Yes                  | Yes                  | Yes                  | Yes                  | Yes                  |
| Time-fixed effects     | Yes                  | Yes                  | Yes                  | Yes                  | Yes                  | Yes                  |

Standard errors in parentheses

All tests two-tailed \* significant at 10%; \*\* significant at 5%; \*\*\* significant at 1%

The study also contributes to the current understanding of the differential corporate attention to various stakeholders. Takeover protection leads to higher managerial attention to the natural environment and community, but has no effect on attention to customers, employees, or minorities. Moreover, the stock market undervalues corporate attention to community, the natural environment, and minorities, but not to customers, or employees. One interpretation of these somewhat surprising findings may be that community, the natural environment, and minorities represent institutional stakeholders that impose normative expectations on firms. In contrast, employees and customers are technical stakeholders with whom the firm is involved in resource exchanges (Mattingly and Berman, 2006). Benefits that accrue to the firm from attending to institutional stakeholders are uncertain and difficult to assess by shareholders. For example, by catering

to community, minorities, and the natural environment, firms can acquire intangible and difficult to measure resources (Atkinson and Galaskiewicz, 1988; Dechant *et al.*, 1994; Galaskiewicz, 1985; Hart, 1995; Shrivastava, 1995), such as legitimacy and reputation.

Conversely, benefits that accrue to the firm from attending to employees and customers are easier to assess by shareholders because those stakeholders are more central to shareholder value, representing part of the firm's traditional production function (Delery and Doty, 1996; Pfeffer, 1994). A body of work further shows that customer and employee-friendly firms are able to attract and retain a better quality workforce, securing higher sales and greater shareholder value (Berman *et al.*, 1999; Luo and Bhattacharya, 2006; Sen and Bhattacharya, 2001; Turban and Greening, 1997; Waddock and Graves, 1997). Together, these findings

indicate that, when protected from takeover threats, managers extend their attention to institutional stakeholders—community and the natural environment—typically undervalued by the stock market.

Consistent with the results suggesting that the stock market undervalues corporate attention to institutional stakeholders, the study finds that firms that increase their attention to those stakeholders experience a subsequent increase in their long-term stock market value. Conversely, since the market does not undervalue corporate attention to technical stakeholders, an increased attention to those stakeholders does not lead to a significant change in the firm's long-term stock market value. Future research could build on these findings in an effort to extend our understanding of how governance affects corporate attention to different stakeholders, and to contribute to the growing body of work that tries to understand the unique contribution of each stakeholder group to a firm's success (Post *et al.*, 2002).

While the results provide support for relief from short-termism—suggesting that takeover protection sets managers free to cater to institutional stakeholders—the question arises whether takeover protection also enabled CEOs to derive direct private benefits. Therefore, in additional analyses, I focus on the impact of the Delaware takeover protection on executive compensation, typically considered a factor that significantly increases managerial welfare (Jensen, Murphy, and Wruck, 2004). To that end, I use Compustat's Execucomp database to collect data on total current compensation (TCC), which includes salary, bonuses, and other annual compensation. The results (Table 4) show that executive compensation is higher for takeover-protected Delaware-based firms compared to firms in the control group.

This finding indicates that, in addition to higher attention to stakeholders, the takeover protection in Delaware directly increased managerial welfare via greater total compensation. One interpretation of these results suggests that, immune to takeover threats, managers may have diverted part of corporate resources to directly increase their welfare, while committing part of the resources to support the interests of non-shareholding stakeholders. Hence, one policy implication of these findings would be to enact state-level takeover protection in conjunction with policy instruments to discourage CEOs from pursuing excessive private benefits.

Table 4. OLS regression results: CEO compensation and takeover protection

| Variables              | Total current compensation |
|------------------------|----------------------------|
| Takeover protection    | 169.648**<br>(81.122)      |
| Post 96                | 341.539***<br>(105.253)    |
| Staggered board        | -133.341<br>(86.476)       |
| Delaware incorporation | 107.028<br>(81.590)        |
| Governance Index       | -7.912<br>(15.511)         |
| Leverage               | -54.919<br>(195.668)       |
| Performance            | 1,822.645***<br>(322.988)  |
| Size                   | 487.409***<br>(31.308)     |
| Pension fund ownership | 49.728***<br>(10.663)      |
| Insider ownership      | 16.144<br>(52.441)         |
| Observations           | 3996                       |
| Number of firms        | 782                        |
| R-squared              | 0.23                       |
| Firm-random effects    | Yes                        |
| Time-fixed effects     | Yes                        |

Standard errors in parentheses

All tests two-tailed \* significant at 10%; \*\* significant at 5%;  
\*\*\* significant at 1%

Future studies could further investigate how external governance mechanisms, such as the threat of hostile takeovers or activist shareholders, should interact with managerial compensation to impact the welfare of non-shareholding stakeholders.

A number of additional suggestions for further research relate directly to the limitations of the study. A promising avenue of research inquiry would be to investigate the impact of governance on the welfare of non-shareholding stakeholders. The present study is limited with respect to documenting the impact of takeover protection on stakeholder welfare. Instead, the study uses KLD dataset to understand corporate attention to stakeholders, consistent with the recent developments in stakeholder research that conceptualize KLD measures as the indicators of social action toward stakeholders rather than the indicators of social performance outcomes (Mattingly and Berman, 2006). Conceptualized in that way, KLD data provide appropriate measures for the purpose of this study, which focuses on the inputs of corporate

attention toward stakeholders rather than the outcomes of those actions.

Furthermore, KLD data have been broadly criticized for their subjectivity triggered by the perceptual standards used by rating agencies in general. Critics of KLD argue that subjective rating standards limit the validity and reliability of KLD's measures as the indicators of corporate attention to stakeholders (Entine, 2003). Furthermore, in a recent study, Chatterji, Levine, and Toffel (2007) find that KLD environmental measures are poor predictors of firms' future environmental performance.

Although KLD dataset may be subject to limitations inherent in social rating systems, its advocates argue that the data provide a set of reliable and valid measures of corporate attention to stakeholders (Mattingly and Berman, 2006; Sharfman, 1996). Because the purpose of KLD is to deliver objective information on corporate attention to stakeholders to institutional investors, the rating agency has an incentive to remain objective rather than to be politically or ideologically driven. Nevertheless, using more objective measures of social consequences of corporate behavior, such as corporate expenditures on stakeholders as a proportion of sales or profits, would enrich our understanding of mechanisms underlying corporate attention to stakeholders. Hence, developing and testing objective indicators of corporate attention to stakeholders is one of the most important directions for future research.

Although this study documents that firms protected from hostile takeovers are more likely to make charitable contributions to community and attend to the natural environment, the study is limited with respect to teasing out the instrumental and normative components of those actions. Indeed, one interpretation of the findings may be that firms engage in a *separation fallacy* (Freeman, 1994) in that they separate 'business' from 'ethics,' buying off the support of stakeholders via charitable donations to community and corporate support to the natural environment. In partial support of this interpretation, I find that shareholders benefit from higher attention to non-shareholding stakeholders. Yet another interpretation of the findings would suggest that, when immune to takeover threats, managers are able to integrate socially responsible and value-enhancing actions and to achieve 'win-win' outcomes. This interpretation is consistent with Freeman's claim contending that, even

though attention to stakeholders has traditionally been regarded as either the means to achieve managers' and stockholders' ends or as the firms' moral and ethical obligation to all stakeholders, self-serving and other-serving corporate behaviors are inseparable (Freeman, 1994).

Whereas this study indicates that instrumental motives may underline corporate attention to stakeholders, one could not eliminate the alternative explanation suggesting that, when relieved from takeover threats, managers are more likely to act as 'good citizens' and to enhance the welfare of shareholders and non-shareholding stakeholders alike. Future studies could contribute to this discourse by teasing out empirically the motives behind managerial attention to stakeholders. Furthermore, examining if and how corporate efforts to address the needs of stakeholders improve the welfare of those constituencies would shed more light on this debate.

## CONCLUSION

This study is the first one to document the positive effect of takeover protection on corporate attention to stakeholders. In the context of hostile takeovers, two coexisting conceptions of the purpose of the firm are directly compared. The study finds that when managers are immune to hostile takeovers, they broaden their conceptualization of value creation that privileges the interests of shareholders and technical stakeholders, such as employees and customers. Incumbent CEOs expand their attention to institutional stakeholders, such as the community and the natural environment that are indirectly connected to the public corporation. The study further finds that firms that expand their attention to include institutional stakeholders experience higher shareholder value in the long run. Overall, the findings make a step toward advancing a new understanding of corporate governance—one that eschews a narrow focus on shareholder interests to incorporate a broader view of balancing the interests of all stakeholders in the process of creating value for organizations and society today.

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## Appendix

Table A1. Poisson regression results Corporate attention to stakeholders and takeover protection

| Variables              | Stakeholders<br>(1) | Community<br>(2)     | Minorities<br>(3)   | Environment<br>(4)  | Employees<br>(5)    | Customers<br>(6)    |
|------------------------|---------------------|----------------------|---------------------|---------------------|---------------------|---------------------|
| Takeover protection    | 0.131**<br>(0.052)  | 0.312***<br>(0.121)  | 0.143<br>(0.095)    | 0.302**<br>(0.123)  | 0.001<br>(0.101)    | 0.084<br>(0.166)    |
| Post 96                | 0.388***<br>(0.073) | 0.004<br>(0.151)     | 0.816***<br>(0.152) | 0.223<br>(0.171)    | 0.512***<br>(0.157) | 0.084<br>(0.205)    |
| Staggered board        | 0.035<br>(0.071)    | -0.027<br>(0.155)    | -0.062<br>(0.110)   | 0.163<br>(0.179)    | 0.061<br>(0.121)    | 0.051<br>(0.206)    |
| Delaware incorporation | -0.160**<br>(0.073) | -0.465***<br>(0.153) | -0.111<br>(0.109)   | -0.221<br>(0.173)   | -0.080<br>(0.117)   | -0.119<br>(0.209)   |
| Governance Index       | 0.001<br>(0.012)    | 0.051*<br>(0.027)    | -0.025<br>(0.019)   | 0.024<br>(0.030)    | -0.011<br>(0.021)   | 0.022<br>(0.035)    |
| Leverage               | 0.024<br>(0.138)    | 0.258<br>(0.295)     | -0.208<br>(0.225)   | 1.398***<br>(0.391) | -0.306<br>(0.249)   | -0.996**<br>(0.454) |
| Performance            | 0.072<br>(0.211)    | -0.118<br>(0.519)    | 0.261<br>(0.331)    | -0.519<br>(0.672)   | 0.548<br>(0.371)    | 0.761<br>(0.722)    |
| Size                   | 0.239***<br>(0.025) | 0.457***<br>(0.055)  | 0.326***<br>(0.038) | 0.159***<br>(0.057) | 0.162***<br>(0.041) | 0.164**<br>(0.076)  |
| Pension fund ownership | 0.022***<br>(0.005) | 0.031***<br>(0.012)  | 0.026***<br>(0.009) | 0.017<br>(0.017)    | 0.010<br>(0.010)    | 0.040**<br>(0.020)  |
| Insider ownership      | 0.016<br>(0.033)    | -0.030<br>(0.078)    | 0.014<br>(0.057)    | -0.049<br>(0.089)   | 0.009<br>(0.064)    | 0.117<br>(0.102)    |
| Observations           | 4538                | 4538                 | 4538                | 4538                | 4538                | 4538                |
| Number of firms        | 878                 | 878                  | 878                 | 878                 | 878                 | 878                 |
| Log likelihood         | -6511               | -2391                | -3745               | -2147               | -3308               | -1508               |
| Firm-random effects    | Yes                 | Yes                  | Yes                 | Yes                 | Yes                 | Yes                 |
| Time-fixed effects     | Yes                 | Yes                  | Yes                 | Yes                 | Yes                 | Yes                 |

Standard errors in parentheses

All tests two-tailed \* significant at 10%; \*\* significant at 5%; \*\*\* significant at 1%



Table A2. Logistic regression results Corporate attention to stakeholders two and three years before the takeover protection

| Variables                  | Stakeholders      |
|----------------------------|-------------------|
| Pre-change (1993 and 1994) | -0.483<br>(1.35)  |
| Staggered board            | 0.360<br>(1.27)   |
| Delaware incorporation     | -0.458<br>(1.72)  |
| Governance Index           | 0.051<br>(1.02)   |
| Leverage                   | -0.625<br>(1.00)  |
| Performance                | 2.390<br>(2.17)*  |
| Size                       | 0.647<br>(5.72)** |
| Pension fund ownership     | 0.355<br>(4.61)** |
| Insider ownership          | -0.242<br>(1.53)  |
| Observations               | 4538              |
| Number of firms            | 878               |
| Log likelihood             | -1753             |
| Firm-random effects        | Yes               |
| Time-fixed effects         | Yes               |

Standard errors in parentheses

All tests two-tailed \* significant at 10%; \*\* significant at 5%;

\*\*\* significant at 1%