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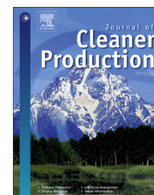

Corporate social responsibility as an entrenchment strategy, with a focus on the implications of family ownership

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A B S T R A C T

Taking as its basis the classical agency conflict between owners and managers, this article investigates issues of managerial discretion, entrenchment and corporate social responsibility (CSR) in family firms. Using an international sample, its purpose is to examine the promotion of CSR as a strategic shield against the costs of managerial discretion and to determine whether this use of CSR is moderated by family ownership. The results obtained support the argument that CSR may provide managers who manipulate earnings, as a discretionary practice, with the opportunity to entrench themselves. This would be an outcome of the decrease in activism and surveillance by stakeholders whose social and environmental demands are satisfied by the exercise of CSR. Thus, by satisfying stakeholders' demands, managers can use a socially responsible strategy as a mechanism for self-defence. Moreover, our results show that CSR is moderated by the ownership structure of family firms. Family owners serve as active monitors of managers, thus alleviating the classical agency problem and decreasing both the risks associated with managerial discretion and the use of CSR as entrenchment.

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1. Introduction

From the perspective of the agency conflict between owners and managers (Shleifer and Vishny, 1989), this paper examines the possible existence of an entrenchment mechanism based on actions of corporate social responsibility (hereinafter CSR); CSR has been defined as the "corporate integrated responsibilities encompassing the economic, legal, ethical and discretionary expectations that the society has of organizations" (Carroll, 1979).

The rationale for this study is the separation between property and control that is the basis for the agency theory; according to this theory, a shareholder (the principal) delegates the management of the firm to a manager (the agent). The latter acts for the former. However, because of their conflict of interests between the principal and the agent and the differences in their access to information, and because it is difficult for the principal to check on the manager's activities (Jensen and Meckling, 1976), the central assumption of this paper is that the self-interest of the agent results in opportunistic and/or discretionary behaviour. This behaviour arises from an excessive autonomy in decision-making processes that gives managers the opportunity to pursue their own self-interest (Eisenhardt, 1989) rather than the corporate benefit.

By exploring this discretionary behaviour and the agency cost for CSR, we hypothesise that managers could over-invest in social and environmental concessions as a self-defence strategy (Rowley and Berman, 2000; Schneper and Guillén, 2004). Their aim is to ensure their job security, to strengthen their position, to avoid stakeholders' reactions, and, overall, to pre-empt the costs of managerial discretion. Thus, as a hedging strategy to avoid stakeholders' negative reactions, for example through costly boycotts and lobbying, media campaigns, or greater activism and scrutiny (Pagano and Volpin, 2005; Surroca and Tribó, 2008), managers could satisfy stakeholders' demands by following CSR practices and, in this way, expropriating shareholder wealth (Cespa and Cestone, 2007; Prior et al., 2008; Surroca and Tribó, 2008).

In addition to addressing the possibility that CSR practices may mask practices of managerial discretion and facilitate entrenchment (the expropriation of wealth from shareholders), this study makes a contribution with its focus on family ownership as a possible control mechanism that underlies the relationship mentioned above (La Porta et al., 1998). It has been suggested that the presence of blockholders may constitute a mechanism that

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inhibits this type of entrenchment practice (La Porta et al., 1998; Surroca and Tribó, 2008). In this respect, family firms are, in general, characterised by a high concentration of ownership in the family, who are often majority shareholders and can perform various functions in the management of the firm (Haalien and Huse, 2005). Thus, although family members can act as shareholders and as decision-makers, this paper only examines family ownership as a control mechanism, focusing on the special agency problem that appears in family-owned firms, where family members are majority shareholders (Chen et al., 2008). In this situation, the classical agency problem between managers and shareholders is diminished because the shareholders have more information and can monitor the managers more closely than in a non-family business (Chau and Gray, 2010; Chen et al., 2008; Chrisman et al., 2004). Therefore, as a secondary research goal, we examine the moderating effect of family ownership.

In summary, this paper addresses the following questions: (1) Does the agency conflict between owners and managers promote managerial discretion? (2) Are CSR-oriented policies used as a tool for managerial self-defence? (3) Compared to non-family firms, does family ownership minimise agency problems and thus the use of CSR as an entrenchment mechanism?

The remainder of this paper is structured as follows. In Section 2, we describe the theoretical background that supports our research hypotheses. Section 3 describes the research model, data and sample. Finally, Sections 4 and 5 present the results obtained and the conclusions drawn, respectively.

2. Research hypotheses

2.1. Theoretical background: Agency theory

Most large companies are owned by a multitude of shareholders and investors. Such companies are characterised by a clear separation between property and control which, in turn, leads to conflicting interests, to different levels of risk aversion between shareholders and managers, and, moreover, to different abilities to access information, which limits the verification of the managers' activities (Jensen and Meckling, 1976; Jones, 1995). According to agency theory, this separation can lead to conflicts of interest: (i) between shareholders and company managers (the Type 1 agency problem), as a result of which managers' decisions may not always coincide with shareholders' objectives (Jensen and Meckling, 1976); and (ii) between minority and majority shareholders (the Type 2 agency problem), which can generate expropriation issues as a result of information asymmetries between the two groups (Shleifer and Vishny, 1989).

The fundamental concern of this study is to investigate managerial discretion behaviour, which is an aspect of the potential agency conflict between owners and managers (Type 1) under the basic assumption of the self-interest of managers and owners.

But, first, in order to put this concern into context, the question that may be formulated is the following: do the managers' interests run parallel to the owners' interests? Considering the degree of freedom and discretion permitted to managers in order to encourage corporate decisions (Langfred, 2004), that is, their autonomy in the decision-making process, Shimizu (2012) distinguishes between two opposing types of managerial behaviour with respect to shareholders' interests: (1) from a positive point of view, managers need to be encouraged in autonomous behaviour so that they pursue corporate entrepreneurship as a mechanism for exploring new strategic decisions “outside the scope of the current strategy”; and (2) from a negative point of view, as an agency problem, excessive autonomy gives managers the opportunity to pursue their self-interest (Eisenhardt, 1989). A high degree of autonomy can lead managers to act opportunistically, being more concerned with their own interests than in the corporate strategy (Shimizu, 2012).

According to the second perspective proposed by Shimizu (2012), on which this paper is focused, when shareholders' and managers' interests are not well aligned, managers may take advantage of their position and their wide managerial autonomy and support actions that promote their own benefit. This implication, derived from the separation of the attributes of ownership and control, was initially reflected in the research of Berle and Means (1932), who termed it managerial discretion. According to these authors, agency conflict is the basis for managerial discretion, which is seen as the opportunity for managers in the decision-making process to serve their own objectives rather than the objectives of their principals by, for example, using investors' funds to obtain private benefits (such as goods for their personal use or excessive remuneration) or making investment decisions that are prejudicial to the shareholders' interests (Healy and Palepu, 2001).

Moreover, in this agency context, it is necessary to recognise that there are some mechanisms by which managers can retain control and protect their jobs, personal status and prestige, and lessen the monitoring by the shareholders (Florackis and Ozkan, 2009) while continuing their discretionary behaviour. That is, there are mechanisms that allow managers to preserve their private benefits in a way that runs counter to the maximisation of the owners' wealth (Shleifer and Vishny, 1989).

From this type of agency problem – the conflict of interests that arises from the separation of the attributes of ownership and control – and in a context in which there is information asymmetry between managers and owners, one area that merits attention is that of the power of the shareholders to control the managers; the most important instrument here is the vote. More concretely, attention should be given to the role played a specific interest group, namely the family shareholders in a family firm. Following Chen et al. (2008), we define a family firm as one in which the family founders remain in senior managerial positions, are present on the board or are able to act as blockholders. Nonetheless, as regards the amount of information available to the different parties, family firms are not homogeneous. Majority shareholders tend to have access to more information than minority shareholders (Ali et al., 2007; Chen et al., 2008; Landry et al., 2013). Moreover, since in a family firm the majority shareholders are actively involved in both controlling and monitoring managers, there is less information asymmetry between them and the managers than in non-family firms (Chen et al., 2008). Accordingly, the classical agency problem between managers and shareholders is smaller, which will have an impact on the ability of managers to use their discretion in decision-making processes; family shareholders have more information and can control managers more effectively than the shareholders in a non-family business (Chen et al., 2008; Chrisman et al., 2004).[1]

In summary, the conflict of interests between a principal and an agent (a Type 1 agency conflict) is of fundamental interest in this

[1] Note that an exceptional agency problem arises in a family business when there are family and non-family investors (Chau and Gray, 2010), i.e. majority and minority shareholders. Family members have access to more information than outsiders, since they participate actively in most business activities, and so Type 2 agency problems can occur. Such a conflict between the majority and the minority shareholders' interests could lead to one or the other of the two perspectives proposed by Cho et al. (2013): “the adverse selection effect” and “the information efficiency effect”. According to the former, family members may act opportunistically and aggravate information differences; according to the latter, more informed investors can disseminate information to other investors, thus reducing information asymmetries.

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