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MANAGERIAL IRRESPONSIBILITY AND FIRM SURVIVAL

Pivoting the company in the aftermath of a social scandal

FrancoAngeli

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FrancoAngeli

A Nicolò Ernesto,
mia gioia e speranza

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Introduction

This study is focused on the analysis of the factors that underlie managerial social irresponsibility scandals and the dimensions that influence the possibility to pivot the company back to success after a social scandal. Three characteristics distinguish organizational crises due to social scandals: (a) they often have such a significant negative impact on corporate performance to pose the very survival of the firm at risk; (b) social evaluations of the firm determine both the emergence and the possibility to resolve these corporate crises; and (c) time is crucial, as the rapidity of the effective management of the crisis enhances the chance of its successful outcome. Thus, indications regards the relevant dimensions to analyse and the types of actions to take following social scandals may improve the rapidity and effectiveness of the management of these corporate crises, increasing the chances of their success.

The thesis proposed in this study is that the capacity to pivot the company back to sustainable survival in the aftermath of social scandals depends on the interplay between legitimacy loss and restoration, on the one hand, and the reputation of the company, on the other hand. Whilst legitimacy signals the firms' alignment to cognitive, moral and pragmatic social norms and expectations, reputation signals the firms' capacity to create value. Though these social evaluations are distinct, the argument made in this volume is that they are interconnected, as social irresponsibility scandals trigger an active process of overall re-evaluation of *both* aspects by all firm observers. The positive judgment of legitimacy restoration and firm reputation are both necessary to restore or maintain the relationships on the basis of which firms may sustainably draw resources and support from their environment. In this view, therefore, the social and the competitive dimensions of corporate action influence each other mutually and are critically connected to the possibility to pivot culpable firms back to success in the aftermath of a social scandal.

As the capacity to maintain or restore the relationships with its constituent audiences is "coin of the realm" for the firms' post-scandal survival, the perspective adopted in this study leverages the most recent research regarding the microfoundations of social evaluations. These studies emphasize that rational reasoning is part of a more complex cognitive and social process which is subject to the influence of biases, framing, heuristics, social pressures and path dependencies that influence the outcomes of social evaluations. By understanding the specific role and dynamics of the elements that contribute to social evaluations, managers called to tackle organizational crises caused by social scandals may base their choices and actions on a more precise picture of the critical aspects underlying the success of their endeavor.

The motivations underlying the choice of theme of this research stem from both its empirical and its theoretical relevance. From en empirical perspective, the pervasiveness of managerial social irresponsibility, the economic and social harm that derives from corporate wrongdoing and the availability of many examples of post-scandal management to analyze, contribute to the salience of the theme chosen. In the first place, in fact, the large number of scandals that rocked the corporate world since the end of the twentieth century have fueled a considerable body of research regarding the antecedents that drove company elites to adopt socially irresponsible behaviors and the proposal of institutional remedies which may discourage the repetition of such episodes, whilst analyses focused on the post-scandal challenges to management are not as numerous.

Notwithstanding the efforts that have been made to reform corporate governance models, the design of effective compensations systems, the institutionalization of codes of conduct, the enhancement of the effectiveness of whistle-blowing actors, and the approval of legal norms and sanctions to curb socially irresponsible actions. There is a growing realization that white-collar crime and unethical corporate behaviors are still very diffused and even more widespread than previously believed (Zhara *et al*., 2005; Ashforth *et al*., 2008).

Furthermore, corporate socially irresponsible actions are just one manifestation of the widespread adoption of unethical and illegal behaviors that is increasingly present in all organizational forms. Mass media reports are a litany of cases of socially irresponsible behaviors that emerge in organizations such as nonprofit firms, public institutions, government, sport, and even religious organizations (Zuckerman, 2006). Part of the processes that undergird corporate survival of social crises will be applicable, by analogy and with the necessary variations due to their specific role and nature, also to other types of organizations.

The economic and social consequences of corporate social irresponsibility are far reaching. In fact, though the antecedents of single instances of managerial social irresponsibility are usually not systemic, their consequences are. The breach of trust that is entailed by unethical and illegal corporate behaviors spills-over and negatively influences the other companies belonging to the same industry and network of the culpable firm (Barnet & King, 2008; Jonsson et al, 2009; Bitektine, 2011). More crucially, the crisis of confidence that follows repeated social scandals (Gioia, 2002) has a systemic effect that results in the significant reduction of the social capital in the wider economic system. As Fukuyama (1985) shows, social capital is key to the fluidity and competitiveness of economic systems and its destruction has long lasting effects as trust is quickly destroyed, but is reconstructed slowly. Consequently, the analysis regarding the reintegration of the culpable firm after a social scandal illustrates the mechanisms that undergird the intentional reconstruction of the trust relationships between the focal organization and its constituent audiences and, in time, with the wider social system. Successful turnaround processes following social scandals are, therefore, a contribution towards the recreation of the social capital of the firms' context.

Not all firms survive social scandals, the spectacular liquidation of Enron following its financial meltdown in 2001 is just one example of organizations that have been wiped away as a consequence of social disapproval. A large part of the companies involved in social irresponsibility scandals are prominent economic players and their demise can modify the competitive landscape of the ecosystems in which they operate, and profoundly harm the economic wellbeing of their stakeholders and of entire territories. The comprehension of the factors and mechanisms underlying the possibility to successfully leverage the "healthy" parts of the organizations that have committed socially irresponsible actions is therefore in the interest not only of the company's stakeholders, but also of the territories and the ecosystems in which the firm operates.

The possibility to conduct rigorous research on the aftermath of social scandals has increased in recent years. In fact, the time lag since the upsurge of social irresponsibility scandals allows to shift attention towards the post-scandal consequences and the factors that influence the capacity of culpable corporations to survive the crises these scandals ignite (Pfaffer *et al.*, 2008; Goodstein & Butterfield, 2010; Hurley *et al.*, 2013; Zavyalova *et al.*, 2013).

Though the many reasons that justify the empirical relevance of theme regarding the management of the culpable firms' turnaround in the aftermath of a social scandal have stimulated the development of fervent research in this direction, a number of theoretical gaps still remain. A first relevant limit that has characterized many studies is the use of a poorly defined notion of managerial social irresponsibility. In part, this weakness stems from the persistent unbalance between the focus on socially responsible actions, rather than socially irresponsible managerial actions that has continued to characterize management studies. The consequence is that irresponsibility has often been intended as “low social responsibility” or the failure to act responsibly. Yet, socially irresponsible actions entail a degree of managerial intentionality and pro-activity, and a pervasiveness of negative effects that are much more far reaching and influential than this perspective would suggest. Therefore, the analysis of social irresponsibility requires the elaboration of a specific interpretative framework, in order to account for its numerous distinctive traits. This limit has only recently been underscored and begun to be addressed (Lange & Washburn, 2013; Crane, 2013).

The exact consequences of the widespread perception of corporate social irresponsibility are also an open theoretical issue. In particular, extant literature largely takes for granted that the consequences for the corporation of being perceived as socially irresponsible is the loss of its legitimacy and, consequently, of the support of its main audiences (Salancik & Meindl, 1984; Strachan *et al.*, 1983; Davidson *et al.*, 1994; Baucus & Baucus, 1997; Haunschild *et al.*, 2006; Karpoff *et al.*, 2008). Recently, different studies have advanced the idea that legitimacy and audience support may be restored, provided the firm engages in an effective and substantial trust reconstruction process with its constituent audiences (Pfaffer *et al.*, 2008; Goodstein & Butterfield, 2010; Hurley *et al.*, 2013; Zavyalova *et al.*, 2013). According to the latter view, however, the restoration of audience support is an implicit automatic consequence of legitimacy reconstruction. In this view, thus, firm survival after a social scandal depends uniquely on the capacity to engage in an effective legitimacy restoration process. This position, however, leaves unexplained how come there are similar firms, that have conducted similar irresponsible behaviors, caused similar harm, and have engaged in parallel legitimacy reconstruction processes, that have had very different audience reactions.

The key question, therefore, becomes whether the loss and reconstruction of legitimacy is the only social evaluation that guides audience decisions following corporate wrongdoings, or existing theoretical frameworks are missing part of the picture. By focusing on the diverse aspects that undergird audience post-scandal decision processes, this study responds to the repeated calls in management studies for the necessity to shed light on the under-researched theme of the main dimensions underlying the processes of the loss and recovery of social approval (Jonsson *et al.*, 2009; Pollock *et al.*, 2008; Westphal & Deephouse, 2011).

Though social irresponsibility attributions emerge as a consequence of illegal or unethical behaviors that create a dissonance between expected social behavior and perceived corporate actions, triggering cognitive, moral and pragmatic legitimacy reassessments, there are different forms of social evaluation observers may express regarding organizations. Each form of social evaluation has cognitive and social specificities that imply a different strategy underlying its increase, maintenance, loss and restoration. This implies the possibility that firms maintain and manage diverse social evaluations contemporarily. Though the relevance and complexity of managing different forms of social evaluation has recently been underscored (Bitektine, 2011; Deephouse & Carter, 2005; Mishina *et al.*, 2012), it has not constituted the focus of specific research and remains to be further clarified. The scrutiny of the aftermath of managerial social irresponsibility scandals highlights the effects of one social judgment on the other, and the combined influence they may exert on the sustainability of firm survival.

The continuation of this study is structured as follows: in the first chapter, extant literature regarding the antecedents and consequences of the firm's social behaviour is systematically reviewed. The findings of years of corporate social responsibility studies are synthesised and particular emphasis is given to the idea that social engagement connected to the company's value chain has a more pervasive and sustainable positive effect for both the society and the focal firm. The shift from the idea of social irresponsibility as "low" responsibility to the identification of its distinctive traits is underscored, and the content and scope of the notion referred to in the present study is clearly defined. Extant literature regarding the antecedents and consequences of managerial social irresponsibility is reviewed in order to clarify the state of current knowledge on the theme.

On the basis of the general idea that firms are considered socially irresponsible only to the extent that individuals perceive them as such, the second chapter shifts attention from broad structure reasoning to the scrutiny of the cognitive and social processes that undergird the perception of managerial wrongdoing. The chapter leverages and integrates two recent studies that regard the factors that enhance the perception of managerial social irresponsibility (Lange & Washburn, 2012), on the one hand, and the factors and managerial capabilities that may render the latter more arduous (Crane, 2013), on the other. It is argued that understanding the dimensions underlying individual perception allows to distinguish instances of managerial social irresponsibility that at a first glance seem similar. The importance of being able to single out the nuances underlying different cases of corporate wrongdoing is underscored and, in parallel, so is the importance of being able to aggregate individual perceptions of firm attributes into shared organization images. The criteria for moving from individuals to audiences is sketched, and the distinction between company audiences and stakeholders is made.

In the third chapter, the focus is shifted to audience evaluations of the firms' social behaviour. Central to the chapter is the notion of legitimacy. The latter indicates the conformity of entities to formal and informal social norms and expectations and, as such, is considered the driver of social reactions to corporate wrongdoing. In order to comprehend the processes underlying legitimization and de-legitimization on which company crises and survival rest, the research leverages recent studies that integrate institutional legitimacy studies (Suchman, 1995) with the teachings of socio-cognitive studies that shed light on: (i) the evaluator's perspective (Bitektine, 2011); and (ii) on the intra-individual dynamics underlying the aggregation of individual evaluations (Tost, 2011). The effects connected to the loss of legitimacy and the way it often sparks a downward spiral of organizational crisis is illustrated. Studies regarding the restoration of corporate legitimacy are integrated within a coherent framework based on Pfarrer, DeCelles, Smith and Taylor's (2008) stage model. The dimensions underlying legitimacy loss and restoration are confronted with two widely documented cases of managerial social responsibility: the Enron and Parmalat cases. This comparison is particularly telling due to the stark similarities that characterize the cases along all the dimensions identified as relevant for the loss and restoration of legitimacy, nonetheless their post-scandal management have had opposite results. Enron was wiped away, whilst Parmalat constitutes one of the most successful cases of company turnaround after a severe social scandal. This comparison suggests that audiences decisions whether to maintain or withdraw their support for the culpable firm are not limited to an assessment of the firms' ability to restore its legitimacy, rather it seems based on a more complex set of evaluations.

The puzzling outcome of the comparison between the cases of Enron and Parmalat spark the research conducted in the last chapter of this volume. Its contents regard the different forms of social evaluation of the firm. In particular, the notion of firm reputation is introduced and its distinctive traits are defined. Whilst legitimacy signals the firms' conformity to social expectations, reputation signals' the firms ability to create value. The socio-cognitive dynamics underlying all social evaluations are depicted, and then the specificities that distinguish the creation, maintenance, loss and restoration of firm legitimacy and reputation are scrutinized. The form of evaluation on which audiences base their decisions is significant because the two criteria may lead to different evaluations. On the basis of Bitektine's (2011) and Mishina, Block and Mannor's (2012) contributions, the mechanisms underlying evaluation form selection are reconstructed. On the basis of the mechanisms identified, initial suggestions regards the effects of managerial social irresponsibility on the *sequence* and *interaction between the different forms of social evaluation* are made. These intuitions foster the idea that the perception of corporate wrongdoing triggers an active process of re-evaluation of *all* the aspects underlying audience support (not just the legitimacy of the firm), and spreads form the victims of the firms' actions and the ethically sensitive observers to *all* the audiences of the firm. The deductions made from theoretical research are confronted with the description of two cases of corporate level (Enron and Parmalat) and two cases of business level (Nestlé and Nike) managerial social irresponsibility. These "vignettes" vividly illustrate how legitimacy and reputation assessments are sequenced and interconnected. Furthermore, the cases inductively suggest an intriguing connection between social and competitive behaviour that lies at the basis of the capacity of the firm to sustainability survive corporate social irresponsibility scandals.

1. The path from corporate social responsibility to managerial social irresponsibility

Though the number and relevance of scandals due to corporate social irresponsibility have been consistent and growing worldwide over the last decades, there is still an imbalance in prevalent literature in favor of the issue of corporate social responsibility and the benefits that accrue to the organization and the society as a result. In this perspective, social irresponsibility is considered as a “low level so social responsibility”. In fact, however, corporate social irresponsibility implies a degree of managerial pro-activity and a process of trust and legitimacy destruction that may not be appreciated fully if scrutinized through the lenses traditionally deployed to interpret phenomena of corporate social responsibility. In the pages that follow, the extant literature regarding the social behavior of the firm is recalled and re-conducted within a systematic review. In particular, the antecedents of corporate social responsibility are illustrated according to their level of analysis (contextual, organizational and individual) and the influence of such social behaviors on firm performance are identified. Particular emphasis is accorded to the issue of the link between corporate social behavior and its sustainability and effectiveness when it is connected to the company’s value chain. Thus, not all corporate socially responsible actions are equally as incisive. This perspective recalls Porter and Kramer’s (2006, 2011) idea of shared value, and underscores how social engagement connected to the company’s value chain not only puts the firm in a position to contribute more effectively to widespread social and economic wellbeing, but may also be the source of new competitive advantages.

The final sections are dedicated to social irresponsibility as a distinctive phenomenon that needs to be analyzed through specific interpretative lenses. The boundaries of the socially irresponsible actions that are the object of the present study are defined and the focus on managerial social irresponsibility is justified. Furthermore, the importance of nuances in the