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Ethical Management of Crises

Shareholder Value Maximisation or Stakeholder Loss Minimisation?

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I argue that, in the context of crises, the shareholder value maximisation model, the dominant form of corporate governance, may lead to decisions and behaviours that are in conflict with several *prima facie* duties such as reparation, beneficence and non-maleficence. Drawing on a typology of crisis response and a typology of crises, I contrast the shareholder value maximisation model, which treats the ethical customs of a society as a constraint, with the stakeholder model of corporate governance, which treats ethical customs as an objective. I suggest that, in the context of crises, the stakeholder model may be the ethically more appropriate choice of corporate governance.

- Crisis management
- Stakeholder theory
- Corporate governance
- Shareholder theory

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RISI^M MANAGEMENT SCHOLARS AGREE THAT EFFECTIVE RESPONSE TO CRISES involves an effort to minimise stakeholders' losses (Shrivastava 1993: 30-31; Pearson and Clair 1998: 61, 66). More traditional corporate governance scholars agree that, within legal limits and ethical customs, the only duty of managers is to maximise shareholder value (see Friedman 1970; Jensen and Meckling 1976; Vidaver-Cohen 1998: 395-97; Jensen 2002). But what if, in the context of crises, the goal of minimising stakeholder losses conflicts with the goal of maximising shareholder value? According to the traditional corporate governance principle, managers should minimise stakeholders' losses, only if doing so maximises shareholder value without violating the legal rules and ethical customs of the society. In effect, the shareholder value maximising model of corporate governance expects managers to perform some sort of cost-benefit analysis of their responses to a crisis.

In this paper, I aim to perform three tasks. First, I try to conceptualise how shareholder value maximising managers may respond to different types of crisis. In order to do so, I use two already available typologies: a typology of crisis response and a typology of crises.

Second, I suggest that, even if the shareholder value maximisation model, in theory, requires managers to conform to the legal rules and ethical customs of the society, scholarly studies and our own experiences tell us that, in practice, managers not only often go against some of the ethical customs of the society but they also sometimes break the laws. Examples of this kind of behaviour are numerous. Thus, I argue that, in the context of crises, the shareholder value maximisation model, as currently practised by many corporations, may lead to behaviour and decisions that are in conflict with several *prima facie* duties such as reparation, beneficence and non-maleficence.

Third, I contrast the shareholder value maximisation model of governance with the stakeholder model of corporate governance, which has a different set of assumptions about corporate governance (Vidaver-Cohen 1998: 397; Freeman *et al.* 2004; Sundaram and Inkpen 2004). There are several reasons why I choose the stakeholder model as an ethically more appropriate form of corporate governance in the context of crises:

- ▶ The stakeholder model is generally in agreement with the 'principle of fairness', which highlights the importance of including in corporate governance all stakeholders that might be harmed by the actions or the inactions of the corporation (Donaldson and Dunfee 1994: 260; Donaldson and Preston 1995: 85; Phillips 1997: 57; Van Buren 2001: 494)
- ▶ The stakeholder model recognises and values the idea of 'non-instrumental ethics', which requires that, when there is a conflict between the shareholder model and ethical customs or moral principles, ethical customs should dominate (Quinn and Jones 1995: 23)
- ▶ The stakeholder model has a broad definition of stakeholders: 'any group or individual who can affect or is affected by' the corporation (Freeman 1984: 46; Freeman *et al.* 2004: 365)
- ▶ According to the stakeholder model, the firm must have multiple objectives and managers must consider the interests of all stakeholders (Vidaver-Cohen 1998: 397; Jensen 2002: 236)
- ▶ The stakeholder model has a different 'normative core' (Freeman 1994: 413) and is the main 'contender' to the shareholder model (Jensen 2002)

In essence, I argue that, in the context of crises, the stakeholder model may be the ethically more appropriate choice of corporate governance because the principles of the

stakeholder model lead companies to engage more frequently in proactive and/or accommodating crisis management behaviours even if these behaviours may not maximise shareholder value.

A typology of crisis response

Managers' behaviour in response to a crisis may range from denial, forced compliance and voluntary compliance to going beyond legal expectations and making extra efforts (Shrivastava and Siomkos 1989: 26). This conceptual scheme is consistent with the four-fold typologies provided by other researchers: deny responsibility, admit responsibility but fight it, accept responsibility, anticipate responsibility (Clarkson 1995: 108-109); fight all the way, do only what is required legally, be progressive, lead the industry (McAdam 1973 as quoted in Carroll 1979: 502); reaction, defence, accommodation, proaction (Jawahar and McLaughlin 2001: 411).

A reactive stance in response to a crisis may involve denying responsibility for the effects of a crisis on victims, being uncooperative and shutting all communications. A defensive stance may involve admitting some responsibility but not without fighting it, complying when forced and doing only what is mandated by law. An accommodating stance may involve accepting responsibility for the crisis, and voluntarily attending to the needs of the victims. Finally, a proactive stance in response to a crisis may involve going beyond what the law requires and making extra efforts to identify and help victimised stakeholders, getting the worst about yourself out in public at your time of choosing before the media dig it up, volunteering help and information to prevent the crisis from triggering a chain reaction of other crises, and preparing for such crises in advance (Mitroff and Anagnos 2001: 55-79; Alpaslan *et al.* 2009).

In short, managers may respond to a crisis in at least four different ways: reactively, defensively, accommodatingly and proactively.

A typology of crises

It is possible that for some types of crisis the goal of maximising shareholder value and the goal of minimising stakeholder losses are compatible. After all, shareholders are just another group of stakeholders, and in some crisis contexts, minimising stakeholder losses may at the same time maximise shareholder value, or at least, result in greater shareholder value. In other types of crisis, however, these two goals may be in conflict.

In order to conceptualise how shareholder value maximising managers may respond to different types of crisis, I use and extend Marcus and Goodman's (1991) typology of crises. The typology is based on two fundamental properties of a crisis. First, crises differ in terms of what can be said about their causes (Marcus and Goodman 1991: 284-85): the role of an organisation in causing a crisis may be more deniable or less deniable. Second, crises differ in terms of their effects on victims (Marcus and Goodman 1991: 284-85): the victims of a crisis may be harder or easier to identify.

These two properties of crises have significant implications for shareholder value. Holding everything else constant, a crisis would lower shareholder value more if the organisation could not easily or convincingly deny its role in causing the crisis. For example, Johnson & Johnson's share price would have fallen more if there was strong evidence that the person who poisoned Tylenol capsules in the 1980s was a Johnson & Johnson employee. This would have significantly damaged investors' and consumers' confidence in J&J's management, future earnings, and hence its stock price. Similarly,

holding everything else constant, a crisis would lower shareholder value more if the victims of the crisis can be easily identified and forcefully represented by lawyers in the courts. There are numerous examples of corporate lawsuits that result in high settlement fees or fines, and there are many others where the courts side with the corporations.

These two dimensions suggest that there are at least four types of crisis. The typology presented in Table 1 is adapted from Marcus and Goodman 1991: 285.

		Causes	
		<i>High deniability (easier to deny)</i>	<i>Low deniability (harder to deny)</i>
Victims	<i>Concrete (easier to identify)</i>	'Normal' accidents, e.g. airplane crash Type 2	Endogenously triggered crises, e.g. financial crisis, product tampering Type 4
	<i>Diffuse (harder to identify)</i>	Exogenously triggered 'abnormal' crises, e.g. 9/11 Type 1	Endogenously triggered 'abnormal' crises, e.g. scandal Type 3

Table 1 TYPOLOGY OF CRISES

Source: Adapted from Marcus and Goodman 1991: 285

In the original typology and in their article, Marcus and Goodman focus primarily on two types of crisis:

- ▶ **Crises with high deniability/concrete victims.** Marcus and Goodman argue that 'normal' accidents (Perrow 1984) may belong to this type (Marcus and Goodman 1991: 286). Most accidents 'create an identifiable group of victims who are well represented by legal counsel' (Marcus and Goodman 1991: 286), and the causes of most accidents are easy to deny because organisations often cannot prevent them (Marcus and Goodman 1991: 286; Perrow 1984)
- ▶ **Crises with low deniability/diffuse victims.** Endogenously triggered 'abnormal' crises (Mitroff and Alpaslan 2003: 111) such as scandals caused by managers may belong to this type (Marcus and Goodman 1991: 286-87). Most scandals have 'no immediate victims', and diffuse groups of victimised stakeholders often fail to pose a significant threat to the organisation (Marcus and Goodman 1991: 287); the causes of most scandals are hard to deny because they are 'the results of human and organisational lapses and inadequacies' (Marcus and Goodman 1991: 287)

I extend Marcus and Goodman's logic and typology to include two more types of crisis (see Table 1):

- ▶ **Crises with low deniability/concrete victims.** Some financial crises caused by management or product tampering by employees may belong to this type. The causes of this type of crisis are usually hard to deny (e.g. managers' failure to foresee changes in consumption patterns, to take on too much debt, or evidence of admission of product tampering by employees). These crises may also create identifiable victims such as shareholders, employees and consumers
- ▶ **Crises with high deniability/diffuse victims.** Exogenously triggered 'abnormal' crises (Mitroff and Alpaslan 2003) may belong to this type. Because these crises are exogenously triggered, the causes of this type of crisis are easy to deny. Most of the

victims of this type of crisis, such as 9/11, are diffuse because these crises victimise many people and in many different ways (emotional, symbolic, financial, etc.)

Shareholder value maximising response to crises

How would some of the shareholder value maximising managers, who mostly try to conform to the legal rules but may not always follow the ethical customs, respond to these four different types of crisis?

Marcus and Goodman found that shareholders react more positively when managers respond defensively to a crisis with high deniability and concrete victims (Type 2). This is because the victims are usually easy to identify, and may be forcefully represented by lawyers in the courts but the managers' role in causing the crisis is easy to deny. Thus, shareholder value maximising managers would not admit full responsibility for a Type 2 crisis. They might admit partial responsibility but not before putting up a fight. They would follow the court's orders, but they would not do anything extra for the victims that is not mandated by law. In contrast, if the causes of a crisis are hard to deny and its victims are diffuse (Type 3), Marcus and Goodman found that shareholders react more positively when managers respond accommodately to the crisis and the affected stakeholders (Marcus and Goodman 1991: 288, 299). This is because the diffuse victims of a Type 3 crisis will have more difficulty posing a threat in the courts (Marcus and Goodman 1991: 287). Once the courts' direct threat to shareholder value is considered unlikely, shareholder value maximising managers, without worrying about loss of shareholder value, may accept responsibility for the crisis to get it over with (Marcus and Goodman 1991: 287). They may even attend to the needs of the victims, if they believe that their accommodating behaviour will, perhaps for reputational reasons, increase shareholder value.

In sum, the results of Marcus and Goodman's (1991) empirical study suggest that shareholder value maximising managers may respond defensively to a Type 2 crisis, and accommodately to a Type 3 crisis.

Although Marcus and Goodman's empirical study focused only on Type 2 and Type 3 crises, and only on defensive and accommodative responses to crises, their logic may be extended to Type 1 and Type 4 crises as well as to the remaining two and more extreme types of crisis response: reactive and proactive.

Victims of a Type 1 crisis are often unable to acquire 'legitimacy' and/or 'power' (Mitchell *et al.* 1997), and to increase their potential influence on shareholder value negatively. For it is much more difficult for legal counsellors to represent forcefully in courts a diffuse group of victims and their claims against an organisation that can easily deny its responsibility for causing or mismanaging a crisis (see Marcus and Goodman 1991: 286, 287), or for these stakeholders to organise and employ 'coercive' manipulation strategies such as launching a campaign against an organisation (see Frooman 1999: 202; Frooman and Murrell 2005). Thus, if shareholder value maximising managers respond defensively to Type 2 crises (high deniability, concrete victims), then they may respond 'reactively' to Type 1 crises (high deniability, diffuse victims). That is, they may deny any responsibility for the crisis and its effects on stakeholders. Furthermore, they may be much less cooperative, hide the truth and sometimes shut all communications with victimised and defenceless stakeholders. Firestone managers' handing of the tyre crisis in 2000 is a good example of a reactive crisis response. Not only did they deny responsibility, but they also blamed their employees, the drivers and the Ford Motor Company. Moreover, they did not recall the defective tyres until they had to (Eisenberg and Zagorin 2000; Welch 2001).

Victims of a Type 4 crisis may acquire more legitimacy and power if they don't already possess these attributes, and be able to increase their potential to influence shareholder value negatively. This is because legal counsellors may be able to represent forcefully a concrete group of victims' claims against an organisation that cannot plausibly deny its responsibility for causing or mismanaging a crisis (see Marcus and Goodman 1991: 286, 287), or these stakeholders may choose to employ 'coercive' manipulation tactics or launch a campaign against an organisation (see Frooman 1999: 202; Frooman and Murrell 2005). Thus, if shareholder value maximising managers respond accommodatingly to a Type 3 crisis (low deniability, diffuse victims), then they may respond 'proactively' to a Type 4 crisis (low deniability, concrete victims). These managers may try to avoid escalating the current crisis or triggering a chain reaction of others. In order to appease angry and powerful victims, they may not only admit responsibility, which is hard to deny anyway, but they may also make extra efforts to attend to the needs of these stakeholders and try to get the worst about themselves out in public as soon as they can.

In short, shareholder value maximising managers may respond differently to different types of crisis. They may take a reactive stance in response to a Type 1 crisis, a defensive stance in response to a Type 2 crisis, an accommodating stance in response to a Type 3 crisis, and a proactive stance in response to a Type 4 crisis. Put differently, they may perform some sort of cost-benefit analyses that would primarily aim to maximise shareholder value. Specifically, they may try to minimise stakeholder losses only if doing so maximises shareholder value. Table 2 provides examples of different crisis responses.

Ethical response to crises

Shareholder maximising managers may not always behave according to the conceptual scheme identified above. Crises are complex phenomena and the two dimensions iden-

Crisis type	Crisis response
Type 1 (high deniability/ diffuse victims)	<i>Reactive:</i> In 2000, Firestone denied its responsibility in manufacturing defective tyres. Furthermore, because it was not legally required, Firestone neither informed nor collaborated with the government (Eisenberg and Zagorin 2000)
Type 2 (high deniability/ concrete victims)	<i>Defensive:</i> After the Bhopal Chemical Explosion, Union Carbide announced that the cause of the explosion was sabotage (Marcus and Goodman 1991: 292)
Type 3 (low deniability/ diffuse victims)	<i>Accommodating:</i> When Chrysler was charged with odometer tampering (these charges were later substantiated), Lee Iacocca, the CEO of Chrysler at that time, said: 'it happened; it shouldn't have happened; it won't happen again' (Mitroff and Anagnos 2001: 85)
Type 4 (low deniability/ concrete victims)	<i>Proactive:</i> In 1982, when poisoned Tylenol capsules killed five people, J&J accepted responsibility, recalled all Tylenol products from the shelves, cooperated with the investigators, and disclosed honestly and voluntarily all of their knowledge of the case (Alpaslan <i>et al.</i> 2009)

Table 2 CRISIS TYPES AND CRISIS RESPONSES

tified by Marcus and Goodman (deniability of causes and identifiability of victims) may oversimplify the conceptual schemes that managers use to respond to crises. Nonetheless, according to the traditional corporate governance model, which at best narrowly focuses on legal relations between managers and shareholders (Mason and O'Mahony 2008), conducting cost–benefit analyses is part of managers' duty to maximise shareholder value, and shareholder value maximising managers do perform some sort of cost–benefit analyses even in the context of crises. On the other hand, performing cost–benefit analyses in the context of crises, when dealing with victims' or stakeholders' losses, does not always seem the right thing to do. It seems wrong to deny one's role in causing a crisis just because it is easy to deny and it is not against the law. It seems also wrong not to admit responsibility if the victims of the crisis cannot be identified easily or represented forcefully in courts.

The problem with the shareholder value maximisation model of corporate governance seems to be the following: maximising shareholder value may not *always* be the most important *prima facie* duty in the context of crises. In fact, the shareholder value maximisation model, as practised by some managers, seems to be in conflict with several *prima facie* duties (Ross 1930). For example, the duty of reparation requires managers to make amends for their wrongful acts even when managers' legally appropriate denial of their role in causing or mismanaging a crisis is in the best interests of shareholders. In the context of crises, the duty of beneficence requires managers to act in a way that benefits not only their shareholders but also their stakeholders. The duty of non-maleficence requires managers not to harm or injure others, both before and after a crisis. Denying any responsibility, being less cooperative, hiding the truth and shutting all communications with defenceless stakeholders, even when legally allowed, may further harm or injure these already victimised stakeholders. In the literature, there are numerous examples of behaviour that has failed to satisfy the duty of non-maleficence. The Ford Pinto crisis of the 1970s is perhaps one of the most well-known examples (Gioia 1992).

So what model of corporate governance is more appropriate, at least from an ethical perspective, in the context of crises?

Stakeholder model of corporate governance

According to the stakeholder model, 'stakeholders are identified through the actual or potential harms or benefits that they experience or anticipate experiencing as a result of the firm's actions or inactions' (Donaldson and Preston 1995: 85). Furthermore, 'the interests of *all* stakeholders have intrinsic value, and no set of interests is assumed to dominate the others' (Clarkson 1995; Donaldson and Preston 1995; Jones and Wicks 1999: 207). This does not mean that stakeholders' interests are equally legitimate (Donaldson and Preston 1995: 67; Phillips 1997: 63). Rather, it suggests that, in the context of crises, the duty of stakeholder loss minimisation may sometimes dominate the duty of shareholder value maximisation. According to the stakeholder model, maximising shareholder value is an important goal but it is only one of many goals (Marens and Wicks 1999: 289; Jones *et al.* 2002: 26). In other words, the stakeholder model differs from the shareholder model at least in one very important respect: while the shareholder model treats the legal rules and ethical customs of society as external constraints to the shareholder value maximisation objective, the stakeholder model includes legal rules and ethical customs in the stakeholder loss minimisation objective and not as some external constraint.

Thus, in the context of crises, stakeholder loss minimising managers' consideration of various *prima facie* duties such as the duties of reparation, beneficence and non-maleficence is not unexpected. These managers' decision to act in ways that benefit a stakeholder or a victim may not be based solely on that stakeholder's power, influence or intention to employ 'coercive' manipulation strategies such as withholding critical resources and information, or reputation damage tactics (Frooman 1999: 202; Frooman and Murrell 2005). Nor is it based on the financial self-interest assumption, or a fear of negative government or market reaction (Mackenzie 2004). These managers may pay attention to a particular stakeholder to the extent that stakeholder is harmed or injured by managers' or their organisation's decisions and actions. They may realise their commitments above and beyond the duty of shareholder value maximisation, and make extra efforts to identify those stakeholders that are actually harmed or injured by organisational decisions and actions, even when these managers can easily deny their responsibility for causing the crisis or when they have nothing to do with it. For example, after the fire in 1995 that injured 36 people and resulted in 3,000 lost jobs, Malden Mills refused to leave the Massachusetts region and announced that the company intended to continue to pay employees their full salaries (Ulmer 2001: 603, 604).

Similarly, stakeholder loss minimising managers may recognise that stakeholders that are harmed by organisationally induced crises have the right to be attended to, even when these stakeholders or potential victims are hard to identify. These managers at least intend to respond to a crisis more proactively or accommodately, regardless of whether the causes of the crisis are easy to deny and/or its victims hard to identify. These managers are more cooperative. They may try to attend to the needs of the victims, and focus on the needs of affected stakeholders even when such efforts may not be required legally or contractually. In short, these managers may want and try to minimise stakeholders' losses even if doing so may sometimes fail to maximise shareholder value. And that stance at least *prima facie* seems the ethically more appropriate choice of corporate governance in the context of crises.

Crises often, if not always, raise questions about the legal and ethical aspects of corporations' and managers' responses. One of the guarantors of managers' ethical conduct, particularly in the context of crises, is their ability to acknowledge and value the particularity of a great variety of conflicting perspectives (Solomon 1994: 59). The stakeholder model, with its broad definition of stakeholders, its emphasis on fairness and multiple corporate objectives, and its recognition of the value of 'non-instrumental' ethics, seems to provide managers with the moral basis they may need to do the right thing in the context of crises, and perhaps more importantly, before a crisis hits.

Limitations

This paper has at least two limitations. The first limitation relates to the issue of whether we can know for sure exactly why corporations or managers act the way they do. For example, when a corporation denies any responsibility in causing a crisis, it is not easy to know whether the corporation is culpable or just responding to accusations. Similarly, when a corporation accepts responsibility and accommodates stakeholders' wishes, it may not always be easy to figure out the real intentions of the corporation. A second limitation relates to the grounding of the ideas and models detailed in this paper in a particular set of cultural beliefs and assumptions. Specifically, these ideas are more applicable in the cultural contexts of developed countries. Managers who want to generalise and apply the basic framework of this paper to other contexts must be aware of the limiting effect of cultural assumptions inherent in it.

Conclusion

The main idea of this article is the following: although the shareholder model dominates corporate governance practice (Bradley *et al.* 1999; Margolis and Walsh 2003: 271), it fails to offer satisfying guidelines in crisis situations. In other words, the shareholder model of corporate governance often does not have an ethically appropriate answer to the question of 'how should corporations be governed in the context of crises?' In fact, the shareholder value maximisation model is in conflict with several *prima facie* duties. To address the problem of ethical governance in the context of crises, I contrasted the shareholder model with the stakeholder model of corporate governance, which focuses on how managers balance and respond to the different needs of multiple stakeholders (Rowley 1997: 907; Freeman and Phillips 2002: 334). I argued that the stakeholder model seems to be a more ethically appropriate choice of corporate governance in the context of crises because, unlike the shareholder model, which starts with the objective of shareholder value maximisation and tacks on ethical considerations as a constraint, the stakeholder model starts with the objective of stakeholder loss minimisation, which includes ethical considerations right from the start.

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