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Who bears the brunt? A review and research agenda for the consequences of organizational wrongdoing for individuals

JO-ELLEN POZNER AND JARED D. HARRIS

The subject of corporate misconduct has become a topic of particular interest for scholars in accounting, finance, and organizational studies. Corporate misconduct is broadly defined as “the organizational pursuit of any action considered illegitimate from an ethical, regulatory, or legal standpoint” (Harris and Bromiley 2007: 351). Scholars have investigated the antecedents of misconduct (e.g., Larkin and Pierce, this volume; Palmer and Moore, this volume; Ashforth and Lange, this volume), and to a lesser degree, its immediate consequences for guilty organizations and other firms to which they are linked (e.g., Greve and Teh, this Volume). Significant gaps in this literature are still ripe for exploration, particularly as concerns the longer-lasting effects that organizational wrongdoing can have on individuals employed by those organizations, to whom consequences might adhere, and the consequences of illegitimate behavior for employees below the level of the top management team. That is, although scholars have demonstrated that revelations of financial misconduct lead to immediate consequences for organizational elites, we have scant theory explaining the mechanisms through which the taint of fraud is transferred from organizations to individuals – especially the non-elite – or what the lasting impact for any of those individuals might be.

The link between misconduct at the macro-level and consequences for the individuals who are implicated, either directly or indirectly, seems like an area ripe with opportunity for meso-level theorizing. Furthermore, extending this line of inquiry to employees of

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organizations who have no plausible connection to wrongdoing save the source of their paycheck – for example, entry-level employees, those at satellite offices, those in completely unconnected business units or operating divisions – remains unexplored. How can what we know about individual psychology, biases, and behavior inform the process through which organizational misconduct leeches into individuals’ lives? What can our knowledge of organizational learning, routines, roles, norms, and culture tell us about the ways in which individuals are likely to react to wrongdoing within the organizations they inhabit? Despite the abundance of fertile ground for theorizing, almost none of this research has been published.

Indeed, what we know about the consequences of organizational wrongdoing on individuals is limited to a narrow set of about three dozen studies, roughly evenly distributed among the fields of organizational theory, finance, and accounting, with very little input from researchers in social psychology or organizational behavior. Although researchers have studied a wide range of misconduct at the organizational level, from environmental violations (e.g., McKendall and Wagner 1997) to deceptive sales practices (e.g., MacLean 2002), they have so far neglected the impact of such wrongdoing on individuals. Instead, our knowledge in this particular domain comes from a group of papers that focus primarily on financial misconduct at the corporate level, and the only individuals under observation are C-suite executives and directors, who themselves are generally C-suite executives at their home firms. In contrast, almost nothing is known about the effects of misconduct on the organizational rank and file. How do they adapt? How are turnover rates affected, and for how long? Are lower-level employees’ labor outcomes on the external labor market impacted? How are the careers and outcomes of individuals outside of the organization, but whose work impinges upon misconduct – the regulators and auditors who failed to uncover or sanction wrongdoing, for example – altered by this association?

In addition, even the research on upper echelons tends not to reveal much about the lasting impact on top managers’ future careers. While work tends to study executive turnover, questions about second- and third-order effects remain unexplored. Finally, this research focuses on cases of misconduct that have been detected and made public, which represents only a small portion of the wrongdoing that goes on in organizational life.

The focus on the first-order consequences of detected financial misconduct for individuals within the upper echelons of the implicated organizations is understandable, considering the challenges of empirical analysis and research design, more on which below. Nevertheless, this myopia also demonstrates the relative vacuum in theorizing about much broader phenomena, which are without doubt highly consequential for untold numbers of individuals. As such, we will attempt to use what we do know to generate research questions about the consequences of organizational misconduct for individuals in the hopes of inspiring a new way of thinking about organizational wrongdoing and opening up some promising new avenues of research.

We first review the existing literature on the consequences of being associated with financial misconduct at the organizational level for organizational elites. After defining the relatively limited accumulated knowledge of what is already known, we discuss the challenges of conducting research in this particular area, and propose a set of questions that has yet to be addressed but which has the potential to be studied in an empirically rigorous way. In this way, we attempt to define an agenda for future research that goes beyond the examination of immediate consequences to top managers of firms revealed to have engaged in misconduct, which marks most of our research to date, and aims to explore the deeper consequences of wrongdoing on individuals, which feed back to longer-term implications for organizational life.

Accounting for the consequences of organizational misconduct for individuals

Two primary streams of research address the accrual of consequences of organizational misconduct to top managers and directors. One account, deriving from assumptions of economic rationality, argues that misconduct is a signal of manager and director quality. The other, which takes an institutional perspective, argues that consequences arise from attempts to avoid stigmatization on the part of both organizations and individuals.

While a subset of these papers deals explicitly with organizational wrongdoing, many deal with the related phenomenon of organizational failure, which often results from managerial negligence. For the sake of inclusivity, we have chosen to review this stream of

literature, essentially broadening our definition of misconduct to include performance- and legitimacy-compromising mismanagement.

The signaling account

The canonical work on the consequences of negative organizational outcomes for individuals comes from the finance literature, and in particular the Nobel Prize-winning work of Eugene Fama. Fama (1980) and Fama and Jensen (1983) argue that the labor markets for managers and directors help solve the agency problem by providing an *ex post* settling-up mechanism: poor organizational performance signals to markets that managers are of relatively poor quality, and subjects them to discipline both within the firm and on external labor markets in the form of turnover and reduced compensation (Fama 1980). Similarly, directors are incentivized to maintain their reputation for vigilance and managerial oversight and are penalized when they allow or fail to sanction managerial action that jeopardizes firm performance (Fama and Jensen 1983).

Signaling theory holds that, because of uncertainty and asymmetric information inherent in interpreting organizational processes, information about quality, expectations, and performance can be inferred only through the concrete actions and objective outcomes that serve as signals (Milgrom and Roberts 1982; Shapiro 1982; Spence 1973). Thus, just as managers and directors are rewarded for strong firm performance, so are they penalized for negative organizational outcomes. By this logic, organizational leaders will face labor market penalties for organizational misconduct because the actions of the firms they oversee reflect their inadequacies (Lorsch and MacIver 1989). Underlying this mechanism, of course, are the assumptions that (1) firm performance is a direct and accurate signal of leader quality, (2) firm performance reflects an underlying truth about leaders' skills, and (3) labor markets are rational, efficient information processors (Fama 1980: 296).

As quality managers are valuable because of their social capital (Mizruchi 1996) and human capital – which are signals of legitimacy (Deutsch and Ross 2003; Pfeffer and Salancik 1978; Selznick 1949) – as well as their performance (Herman 1981; Mace 1986), poor performers are devalued (Baum and Oliver 1991; Elsbach 1994; Elsbach and Sutton 1992; Jensen 2006) because they present unfavorable signals of

firm quality. Organizations are, in essence, reflections of their top managers (Hambrick and Mason 1984), and evidence of poor managerial and director oversight ability reflects badly on the organization itself; when director and executive reputations are tarnished, the stain therefore leeches onto the organization, whose reputation is similarly diminished. *Ex post* settling up therefore implies that individuals who might be responsible for setting the tone of the organization or providing oversight, and who are therefore technically accountable for misconduct at the organizational level, may lose both their positions within the misconduct firm and their appointments on other corporate boards.

It is worth noting that this account takes seriously the idea that labor markets are rational and process information efficiently and accurately. That is, this account focuses on markets as abstract actors capable of fulfilling a corporate governance and oversight role. Markets are often described as if they were discrete actors, without real consideration of the sociological forces that distort market efficiency, the social psychological phenomena that interfere with individual judgment, or the possibility that observables can differ in any significant way from underlying realities. This stands in stark contrast to the symbolic management approach, which views the world through a very different set of assumptions.

The symbolic management account

Whereas rational calculations and signaling underlie the signaling account, many scholars argue that the apportionment of the consequences of organizational misconduct to individuals may be a symbolic act driven by concerns tied to legitimacy, status, and social connections. The symbolic management account therefore emphasizes the need for organizational actors to prevent their social identities from being diminished through association with discrediting characteristics or discredited actors, which ultimately leads to the loss of social ties (Goffman 1963; Pozner 2008; Wiesenfeld, Wurthmann, and Hambrick 2008). In the organizational context, this might imply the loss of investors, suppliers, customers, alliance partners, and public support, while for individuals stigmatization implies the loss of network ties and lower-quality labor market outcomes.

Unlike the signaling story provided by the *ex post* settling-up hypothesis, this school of thought does not assume that firm performance is a direct or accurate signal of leader quality or that markets are rational actors. Instead, it assumes that markets comprise a broad set of individual social actors subject to sociological and social psychological influence. This implies that observables are likely to be disconnected from underlying truths about leaders' skills and that labor markets are collectives of largely irrational, inefficient, individual information processors. Individual and organizational outcomes cannot therefore be related to each other in a deterministic way, leading this line of thinking to take seriously the exploration of the conditions under which organizational misconduct might imply consequences for individuals, and the factors that add nuance to this relationship.

Given these assumptions, to avoid stigmatization and to maintain legitimacy and status, with all the benefits and resources they entail (Pfeffer and Salancik 1978; Suchman 1995), organizations may sever ties with actors that might be responsible for misconduct. Likewise, individuals may dissociate from the misconduct firm in an effort to avoid stigma by association. Both types of symbolic action, which are empirically indistinguishable from one another (Pozner 2008), lead to outcomes similar to those predicted by Fama (1980) and Fama and Jensen (1983), but are driven by concerns for actors' legitimacy, status, and social connectedness rather than by signals of underlying quality. Dissociation from potentially tainted interaction partners allows organizational actors to distance themselves from those that might be labeled bad influences (Pozner 2008; Suchman 1995). Such actions might also be used to indicate organizational commitment to change or the undertaking of substantial governance reform to prevent the same kinds of mistakes from happening again, and as such "symbolize contrition" to external stakeholders (Suchman 1995: 598).

Reviewing the findings

There is abundant evidence establishing that directors and top managers of firms found to engage in misconduct suffer penalties; unsurprisingly, both the signaling and symbolic management accounts are supported. Upon reviewing the findings, however, it becomes clear that the different conclusions drawn are not the result of differences in methodology, data, or analysis, but rather stem

from the fundamentally different theoretical approaches to the problem and concomitant articulations of the research question taken by various scholars. In the following sections, we review the research that promotes the signaling account, followed by work that offers mixed accounts, and finally research that suggests a purely symbolic account.

Support for the signaling account

A number of studies provide evidence that is consistent with a strong-form signaling account. In this tradition, markets readily penalize executives identified as most closely associated with misconduct, while going easy on their peers, and outcomes suggest that organizational performance reflects stakeholders' assessments of and information about managerial effectiveness. This research convincingly establishes that penalties do accrue to top managers and directors of firms found to have engaged in financial misconduct and its close cousin, lax corporate governance.

For example, Coughlan and Schmidt (1985) find that board compensation committees exert control over managers by changing the CEO when stock price performance is poor and by altering executive compensation. Warner, Watts, and Wruck (1988) find that extremely poor stock price performance – even in the absence of allegations of wrongdoing – is associated with substantially higher levels of turnover among top managers, including the CEO, President, and Chairman of the Board. Weisbach (1988) presents a similar finding, whereby CEO turnover is predicted by poor stock and earnings performance; this result is particularly strong for those firms whose boards are dominated by outsiders, rather than insiders.

Gilson (1989) finds that more than 50 percent of those firms that are in default on corporate debt, going through bankruptcy proceedings, or privately restructuring debt so as to avoid bankruptcy in any given year experience managerial turnover. When managers of these firms lose their positions, they are unable to find employment at another exchange-listed firm for at least three years. Feroz, Park, and Pastena (1991) similarly find that 72 percent of firms subject to Securities and Exchange Commission (SEC) Accounting and Auditing Enforcement Releases between 1982 and 1989 lost at least one top manager.

Kaplan and Reishus (1990) find that managers who reduce the dividend payout at their own firms are only half as likely to receive new board appointments and more likely to resign from or lose existing external board appointments as are executives of firms that maintain constant dividend streams. Poor home firm performance, it seems, is perceived as a signal of poor management and oversight ability.

Farrell and Whidbee (2000) find that directors' labor market outcomes are influenced by their decision-making with respect to CEO turnover. Outside director turnover increases significantly after a forced CEO ousting, particularly among directors who have little equity, make poor replacement decisions, and are aligned with the departing CEO. Outside directors who own larger equity stakes and who are more independent of the CEO are rewarded when they oust a poorly performing CEO and replace him with a more successful CEO, improving firm performance, and directors that stay on the board are more likely to gain other directorships than those that stay on the board of a matched sample firm. These findings provide evidence that the market for directors takes into consideration directors' responses to organizational crisis in determining the skill level and suitability of an individual to oversight positions.

Coles and Hoi (2003) investigate the relationship between signals of boards' commitment to strong corporate governance and directors' outcomes on external labor markets. They find that firms with directors serving on the boards of Pennsylvania companies that rejected anti-takeover provisions were three times more likely than those that accepted at least some of those provisions to add seats on additional boards. Those directors were also 30 percent more likely to remain on the board of the focal company.

Along the same lines, Wu (2004) finds that, among firms named by CalPERS as having poor corporate governance practice, a large proportion of departing inside directors remain full-time employees. That is, although insiders are removed from boards, they are not fired from their positions at the named firm. Those insiders that are removed from the board, however, are far less likely than a matched sample to receive new board appointments. Taken together, these results indicate that board turnover following misconduct might be an effort to improve governance practice.

Likewise, Fich and Shivdasani (2005) find that while outside directors do not depart the boards of firms sued by shareholders following

financial fraud at an accelerated rate, they do lose seats on the boards of other firms. The loss of director positions is greater for more severe frauds and when outside directors are members of the audit committee, who have greater responsibility for monitoring against fraud. These directors are most likely to lose seats on boards with stronger corporate governance, and their departure from those firms is associated with increased firm value. This suggests that markets attribute negative organizational outcomes to directors' poor oversight capabilities and punish them accordingly.

Srinivasan (2005) finds that although the penalties suffered by directors from lawsuits and SEC enforcement actions following financial fraud are small, the labor market penalties are significant. Within three years of a downward restatement, 48 percent of directors turn over compared to 33 percent of directors of a performance-matched sample of firms, 28 percent of directors of firms that restate earnings upward, and 18 percent of those involved in restatements for technical reasons. Among firms restating earnings downward, director turnover increases with restatement severity, particularly for audit committee members. Finally, directors lose a full 25 percent of their seats on other boards, with greater losses for more severe restatements and audit committee members. The discernment among those more and less accountable for the initial misconduct, and the differentiation of consequences by severity of the misconduct, supports the signaling story.

Desai, Hogan, and Wilkins (2006) find that 59 percent of firms that restate earnings replace their CEO or President within two years, compared with 35 percent of matched-sample firms. Moreover, the future employment prospects of managers associated with restatements are worse than those of the control sample firms, with both corporate boards and external labor markets imposing private penalties, which the authors suggest to replace public enforcement mechanisms. Karpoff, Lee, and Martin (2008) also provide evidence that markets react to signals of managerial competence, finding that 93 percent of those managers identified as "responsible parties" according to enforcement actions brought by the SEC and Department of Justice (DOJ) eventually lose their positions, with the majority being explicitly fired; this compares to 23 percent of executives that are not targeted by the SEC and DOJ, and 20.5 percent of executives within a matched sample of control firms. Targeted executives are also likely to lose their shares in the focal firm, are subject to SEC fines, and lose future employment

opportunities, and 28 percent of them face criminal charges and penalties. The likelihood of being fired also increases with the cost of the misconduct to shareholders and the quality of the misconduct firm's corporate governance.

Hennes, Leone, and Miller (2008) find that markets are able to interpret financial misconduct in a relatively nuanced way. They find that firms with restatements driven by true accounting irregularities – indicating wrongdoing by commission or omission – are seven times more likely to encounter CEO turnover than firms with restatements driven by errors. In firms with true accounting irregularities at the parent (rather than subsidiary) organization, 67 percent of CEOs and 85 percent of CFOs turn over, with at least one of those managers departing the restating firm in 91 percent of cases. That labor market reactions to misconduct are guided by characteristics of the wrongdoing itself suggests that the signaling mechanism is indeed at work.

Additional support for the signaling account is given by Peterson's (2012) finding that accounting complexity in the area of revenue recognition moderates the consequences of earnings restatements, including the incidence of post-restatement CEO turnover. Whereas accounting complexity – a function of the number of words and revenue recognition methods included in the relevant disclosure sections of a firm's annual 10-K financial filing – increases the probability of an earnings restatement, it is also associated with a decreased rate of CEO turnover following the restatement. This evidence that markets consider the complexity of a firm's accounting situation in allocating punishments suggests that they respond to signals of actual managerial capability, rather than symbols of managerial oversight and skill.

Wu (2004) finds that the likelihood of CEO dismissal increases when firms are named by CalPERS as suffering from poor governance, and that the relationship between CEO dismissal and firm performance is strengthened after companies are named by CalPERS, suggesting that firms and markets hold executives directly responsible for negative firm outcomes.

Hazarika, Karpoff, and Nahata (2012) find that forced CEO turnover, but not voluntary turnover, is more likely and comes more quickly at firms that manipulate and subsequently restate earnings. Forced turnover is highest when the earnings manipulation is substantial, making market disciplinary action most likely when the scope of the misconduct is extreme. CEOs ousted because of earnings

management are found to lose their seats on the boards of both the misconduct firm and other firms and are more likely to be sued for misconduct than their peers at non-restating firms. CFOs experience similar penalties, as their forced departure, but not voluntary departure, is accelerated at firms found to be managing earnings. The authors conclude that these results suggest that boards are enacting *ex post* settling-up, disciplining unethical executives in anticipation of market responses.

Finally, Efendi, Files, Ouyang, and Swanson's (1988) study finds that CEOs, CFOs, and General Counsel are forced out at 36 percent of firms accused of backdating options. This is several times higher than the rate of forced turnover among matched sample firms, and the executives fired in the wake of these scandals are substantially less likely than their peers at matched firms to find comparable employment on the external labor market. In addition, to signal a commitment to corporate governance reform, boards tend to change CEO compensation to minimize the component of stock options in overall remuneration.

Moving from signaling to symbolic management

The studies above begin by painting markets as abstract but unified actors, and focus on characteristics of the firm, details of the misconduct, and traits of top managers and directors. Because individual and firm behaviors and social forces do not impinge on this research, any finding of an individual penalty for firm wrongdoing provides support for the signaling account. Once researchers begin to incorporate the behaviors of stakeholders into their analysis, they move away from a pure signaling account and toward a symbolic management account. In these studies, internal and external stakeholders take purposive action to affect the interpretation of signals of firm, manager, and director quality. While these studies do not represent a symbolic management perspective, their approach and findings straddle the line between markets rationally interpreting signals and stakeholders intentionally manipulating interpretations of actions and outcomes.

For example, Klein and Rosenfeld's (1988) study of dubious corporate governance practices finds that, when firms pay greenmail to repurchase a block of stock from a particular shareholder group on favorable terms – they experience above-average turnover within one year. This seems not to be related exclusively to poor stock

performance, as greenmail tends to increase stock returns. Rather, it seems that the greenmail payment is associated with heightened conflict between shareholders and management, as evidenced by the lawsuits and proxy fights that accrue to those firms that lose managers after the greenmail payment relative to those that do not. This suggests that internal mechanisms are at work to monitor top management activity, with directors and large blockholders sanctioning poor managers directly; their motivation stems at least in part from the desire to distance themselves from sanctioning by external stakeholders.

Likewise, while Hilger, Mankel, and Richter (2013) find that poor individual and firm performance accelerate the pace of executive dismissal, they also find that a CEO's power base and effective ownership and governance structures diminish CEO replacement rates, providing evidence that there may be more at work than a straightforward signaling story. Wiersma and Zhang (2011) also find that negative analyst recommendations are associated with a greater likelihood of CEO dismissal, suggesting that it is not objectively rational markets but, to a certain extent, subjective market participants that adjudicate consequences.

Similarly, Harris (2008) finds that the diminished performance consequences associated with earnings restatements are moderated by specific firm responses such as CEO replacement and increased board independence. Although this finding could certainly be interpreted as support for the idea that poor oversight and managerial skill may have led to the initial misconduct, the study also demonstrates that *ex ante* board independence had no dampening effect on that initial misconduct, suggesting that certain governance practices may be primarily effective only as symbolic responses.

Gomulya and Boeker (2014) find that, among firms that experience CEO turnover following restatement, those with more severe restatements are more likely to name successors with prior turnaround experience and elite education. These appointments, which telegraph a commitment to organizational change and an attempt to rectify underlying organizational issues, are likely to result in more positive reactions from stock markets, financial analysts, and the media.

Directors of firms involved in the options backdating scandal of 2006–2007 also faced significant market penalties, particularly those who served on the board's compensation committee during the backdating period, according to Ertimur, Ferr, and Maber (2012). These

directors received fewer votes when up for election, and turned over at higher rates than those of matched sample firms, particularly in more egregious instances of backdating, although those directors did not lose seats on boards that were not associated with options backdating; the latter finding in particular supports the idea that directors might be distancing themselves agentially, rather than being acted on by invisible market forces.

Farber (2005) finds that restating firms have poorer governance practices relative to a control sample in the year before a restatement is issued, with fewer audit committee meetings, fewer financial experts on the audit committee, a smaller percentage of Big four accountants, a higher percentage of dual CEO/Chairmen, and a smaller number and percentage of outside directors. Three years after the restatement, however, the numbers and percentage of outside directors at restating firms rival those of control firms, and restating firms have more audit committee meetings than at control firms. While this study does not find that improvements to corporate governance practice increase or improve analyst coverage or institutional holdings, it does find that such reforms boost stock returns, controlling for earnings performance. This suggests that organizations proactively take steps to influence market reactions, enacting structural changes that symbolize a commitment to correcting firm behavior.

Support for the symbolic management account

A reasonable body of research in the symbolic management tradition focuses not on establishing that consequences accrue to top managers and directors, but rather on how and why they accrue. By taking into consideration the variation in the distribution of consequences, research in this area provides insight into the sociological forces that impinge on the process of penalization. Moreover, it assumes that individuals are actors with agency, motivations, and cognitions, with which they can intentionally manipulate signals and outcomes; penalties, under this regime, may have little to do with signals of underlying quality or culpability, and everything to do with actors' interests in maintaining their status, legitimacy, and social connections.

Some of the earliest support for the symbolic management account comes from a lack of findings in support of the signaling account. Beneish (1999) finds that, following earnings overstatements that lead

to SEC enforcement actions, managers do not lose employment at a higher rate than those not involved in financial misconduct, and that the SEC tends only to impose trading sanctions on those managers who sell their own shares as part of a firm security offering.

Agrawal, Jaffe, and Karpoff (1999) similarly find that senior managers do not experience higher turnover than others following discovery of fraud, based on a sample of fraud firms identified in the "fraud" and "crime" listings in the general section of the *Wall Street Journal Index*. What these studies fail to investigate is the impact of being included in the *Wall Street Journal Index*, which implies a level of public and media attention, or being the subject of SEC enforcement actions, which tend to target highly visible firms to maximize the deterrence effect of their actions. Taken together with the robust findings summarized in the previous section, we might infer that there is less variation in outcomes among individuals associated with highly visible firms – most likely large, high-status organizations – than there is between those highly visible firms and their less visible peers. This, in turn, provides support for the symbolic management account.

Social connections. An important mechanism that links individual consequences to organizational misconduct is stigma, or the loss of social ties through discredited social identity. Because managers and directors in place at the time of the misconduct are symbolically yet inextricably linked to it due to their presumed authority (Cannella et al. 2002; Goffman 1963; Tetlock 1985), they are discredited by association with the misconduct, a fact that can be strategically exploited by organizations interested in preserving their own identities and legitimacy (Arthaud-Day et al. 2006). In addition, high-profile individuals are more likely to be targeted by the press and other public watchdogs, making them more prone to scandal – or scapegoating – than their lower-status peers (e.g., Graffin et al. 2013; Warren 2007). Organizations may therefore dismiss managers and directors in an attempt to symbolically lay blame on those individuals and remove the possibility of them asserting a negative influence in the future (Pfeffer and Salancik 1978; Suchman 1995; Sutton and Callahan 1987).

Studies in this tradition show that managers are stigmatized by association with firms experiencing poor financial performance, leading to deleterious effects on managerial careers (D'Aveni 1989; Daily and Dalton 1995; Hambrick and D'Aveni 1992). CEO turnover is

much higher in firms undergoing poor performance (Gilson and Vetsuypens 1993; Schwartz and Menon 1985; Warner et al. 1988; Weisbach 1988), and stock markets respond quite favorably to managerial changes in firms experiencing unusually poor performance (Bonnier and Bruner 1989; Davidson, Worrell, and Dutia 1993). Arthaud-Day et al. (2006) extended this perspective to the realm of organizational misconduct, and find that CEOs, CFOs, outside directors, and audit committee members leave restating firms up to 70 percent more frequently than they do a matched sample of non-restating firms; they build a convincing case for this being a reasonable symbolic reaction to the threat that restatement poses to organizational legitimacy.

Kang (2008) also finds that reputational penalties accrue to organizations that share connections to misconduct firms through interlocking directorates. This study shows that over 18 percent of firms that share directors with a sample of companies accused of reporting fraud experience abnormally low stock returns. Moreover, these penalties are more severe when the directors serving as links between the tainted and untainted firms served as the chair of the audit or governance committee at the restating firm, but less severe when observable governance structures at the restating firm signal high-quality corporate governance. This suggests that individuals, and by extension, the firms with which they associate, are tainted by their relationships with the misconduct firm. In this case it is the symbolic attachment that provides the primary trigger of reputational penalties, although this effect is moderated by signals of director quality.

Status and legitimacy. Other research illuminates the link between symbolic responses to misconduct and threats to both individual and organizational status and legitimacy. When threats to an actor's social standing are indicated, that actor is far more likely to distance himself from the source of the threat. In other words, if we reinterpret the findings from the signaling account in light of substantive threats to status and legitimacy, we find a very different pattern of results.

Consistent with this line of thinking, Persons (2006) provides evidence that individuals suffer greater consequences when their dirty laundry is aired in the *Wall Street Journal*. Compared to a matched sample of firms, those whose fraud and lawsuits were reported in that newspaper experienced significantly higher managerial turnover, as well as smaller increases in managerial compensation. Evidence of an amplifying effect

of the media suggests that markets are not rational, detached interpreters of events, but rather are influenced by the actions of other stakeholders.

Leone and Liu (2010), in turn, highlight the importance of individual status in directing the allocation of individual consequences of misconduct. They find that the probability of CEO turnover is lower, whereas the probability of CFO turnover is higher, following restatements when the offending organization is a newly public firm and the CEO is the founder, compared to a control sample; non-founder CEOs turn over at a rate of 49 percent following restatement, compared to founder CEOs, who turn over at a rate of 29 percent. This suggests that both boards of directors and external labor markets are influenced not only by rational estimations of culpability but also by the costs associated with divorcing an organization from its primary source of legitimacy and identity: its founder. That individual identities and the durability of an organization's legitimacy play such an important role in determining the allocation of consequences strongly implies that symbolic factors are at play.

Wiersema and Zhang (2013) find that firms accused of backdating stock options later in the scandal's history were less likely to experience executive turnover than those involved earlier. They argue that the heightened media attention associated with early identification with the scandal moderates the rate of managerial turnover. Additional attention drivers, including SEC and DOJ investigations, also amplify the effects of timing and media on executive turnover. Taken together, these findings suggest that increased attention drives the need for symbolic management in a way that is disconnected from rational assessments of managerial skill.

Similar forces seem to be at play in Burks's (2010) study, which provides evidence that the signaling effect of managerial turnover may diminish after the passage of Sarbanes-Oxley. His findings show that, although boards are able to demonstrate their commitment to improving corporate governance following earnings restatements, the highly visible step of firing the CEO is unattractively costly. After Sarbanes-Oxley, when he argues restatements may be less severe, boards move away from CEO termination and instead penalize CEOs through lower bonuses. At the same time, his findings indicate that boards are more likely to fire CFOs after the enactment of Sarbanes-Oxley. This mismatch between the severity of the infraction and the magnitude of the consequence for top managers suggests that the signaling effect of managerial discipline may be secondary to the symbolic effect of board action.

In contrast, Cowen and Marcel (2011) find that the consequences of misconduct on director outcomes are largely the result of the impact of stakeholder attention. Their study finds that non-restating boards are more likely to fire directors associated with misconduct when the percentage of public pension fund ownership is high, more securities analysts cover the firm, and coverage by independent governance rating agencies is present. From the finding that outside stakeholder attention is a primary driver of director consequences, we can infer that it is the need to defend organizational status and legitimacy – symbolic concerns – rather than rational assessments of director quality that influences organizational decision-making.

A complementary perspective is promoted by Boivie, Graffin, and Pollock (2012), who find that directors voluntarily dissociate from firms experiencing shareholder lawsuits and restatements because they endanger director reputation, whereas their motivation for joining corporate boards was to increase their own visibility and improve their reputations. Negative events are more likely to lead to director defection when the firms on whose boards they serve are high-performing and highly visible in the media – characteristics that are generally negatively correlated with director turnover – suggesting that those directors most concerned about defending their reputations are, in fact, most likely to desert in times of trouble. This argument is bolstered by Withers, Corley, and Hillman's (2012) theory that the prestige of serving on a board is diminished when the firm's reputation is tarnished by misconduct, increasing directors' willingness to exit.

Finally, Rider and Negro (2015) find that partners departing a failed law firm generally find new jobs at lower-status firms. Moreover, this status loss increases with partners' tenure in the failed firm's partner structure, but is decreased with educational prestige, independent of demonstrated partner productivity. These results suggest that status characteristics such as education can protect individuals associated with negative organizational outcomes from status loss, lending further support to the symbolic management story.

Moving beyond turnover

Having reviewed the literature dealing with the consequences of organizational misconduct for individuals, it is clear that many gaps remain. Not only is our knowledge confined largely to the realm of financial

misconduct within publicly traded companies, it also addresses a limited group of top managers and directors. This indicates substantial space for further theorizing and empirical research.

This lacuna is an artifact of the difficulty in studying misconduct, which suffers more than most areas of inquiry from the problem of proper identification. The majority of wrongdoing is never revealed – or, at least, this is our assumption as a field – which makes drawing inferences based only on observable cases of organizations that got caught difficult, particularly in light of recent research indicating that firms that get away with financial fraud experience better outcomes than those that do not cheat (Stuart and Wang 2014). Given these limitations, what can we learn from the assumed small population of firms that are insufficiently skilled to hide their wrongdoing in the first place? What factors differentiate firms that are caught from those that are not, and how can we possibly correct for selection bias in running statistical analyses? If fundamental organizational social characteristics such as status, reputation, and performance influence the likelihood of being found out, is it reasonable to draw meaningful inferences about the effect of those characteristics on the outcomes realized by relevant organizational actors? Is it ever possible to pinpoint where accountability for misconduct lies with any degree of accuracy, or are all observable consequences that accrue to individuals possibly the result of scapegoating and impression management? These conundrums make it both risky and intriguing for scholars to enter into the serious study of organizational misconduct.

Because of the challenges associated with conducting high-quality empirical research on organizational misconduct in general, the ability to bring the study of individuals into this research stream is similarly limited. Consequently, research in this area has tended to focus on a few easily identifiable types of misconduct for which data are publicly available and which have clear connections to immediate individual outcomes. The cluster of studies around financial misconduct, options backdating, and questionable corporate governance practices exist because these empirical settings are advantaged by public reporting requirements, easily accessible records, and multiple empirically measurable outcomes.

The consequences for some highly identifiable groups of individuals associated with these forms of misconduct are also relatively easily traceable, particularly as regards corporate executives, directors, and

other public figures; the media, regulatory agencies, and corporate disclosures provide a paper trail for most of these individuals, and those that “drop out” of public life provide similarly useful data on organizational exit, a relevant outcome in this research setting. Thus the majority of what we know about individual consequences of organizational wrongdoing therefore stems from a set of studies in this particular empirical domain.

Nevertheless, the almost exclusive focus on a few particular types of organizational misconduct leaves many questions unexplored. What can we say about organizational corruption or other types of fraud, for example? What lessons might we learn about large-scale, organizationally induced crises – the financial crisis of 2007–2008, for example – if we could access information about the responsible decision-makers, their decision processes, and private allocation of blame? What questions might we ask if we could properly identify a population – or even a truly representative sample – of organizations and individuals engaged in different types of misconduct, such as cutting corners in regulatory compliance, failing to disclose conflicts of interest or outright wrongdoing, or endangering consumers through product defects?

New directions for research

As we have demonstrated, most of what we know about the individual consequences of organizational wrongdoing focuses on the outcomes for executives and directors, which barely scratches the surface of what is possible. As Greve, Palmer, and Pozner (2010) suggest, future research must address how organizational misconduct affects organizational members outside the C-suite and boardroom. We know that failures at the organizational level have a trickle-down effect through the rank and file. For example, the perceived failure of an organization to behave in a pro-social way engenders strong reactions from organizational members (Dutton and Dukerich 1991); we must anticipate that an identity-threatening and potentially stigmatizing act such as organizational misconduct would engender similarly strong responses from ordinary organizational employees. In addition, we propose further study of the long-term and second-order effects of organizational misconduct on top management teams and directors. Below, we enumerate a research agenda focusing on both of these areas of inquiry. Because the availability of reliable data sufficient to address these

questions is limited, we suggest multiple methods through which such research might be conducted.

Long-term implications for executives and directors. Although much of the literature addresses manager or board turnover as a first-order result of organizational misconduct, we know very little about how the fallout from organizational wrongdoing follows upper echelons throughout their careers. In other words, what happens after the immediate aftermath of a corporate scandal arising from misconduct? Further study of these effects could shed light on four specific areas of research inquiry.

1. *Longer-term employment and compensation effects.* For example, executives and board members known to be associated with misconduct could be tracked over time, particularly when they remain involved with public organizations. Given the more advanced ages of many senior executives and board members who achieve and maintain these high-status positions during late career, do these individuals retire earlier than peers who are not implicated or associated with wrongdoing? Are their long-term salaries and bonuses affected, and is the performance-contingent component of their compensation affected?

Studying longer-term effects on a set of specific individuals may simply be a matter of following them over time, identifying employment changes via media accounts and public filings. Supplementing a quantitative and archival approach, future research might pursue in-depth case studies of individuals, including direct interviews. Richer qualitative data on specific individuals' experiences, while not necessarily generalizable, would likely provide deeper insight into the personal and professional toll imposed by association with corporate misconduct.

2. *Decision processes.* Another research opportunity involves the processes through which decisions about consequences for individuals get made. Whether the consequences involve turnover (who stays and who leaves), compensation structure, or other types of organizational sanctions, we know very little from a process standpoint about how these decisions get made. For instance, while several studies we have reviewed have investigated who stays and who goes, the specific mechanisms and managerial processes behind these decisions are not fully understood.

A better understanding of the decision-making process behind the outcomes we observe would be best achieved either through qualitative, ethnographic means, or through the study of board or top management team meeting minutes. Both these research approaches represent significant access challenges, as firms may be reluctant to give a researcher access to such sensitive meetings. Nevertheless, it may be possible to observe these decision-making processes directly as part of an intervention aimed at helping the organization respond to the crisis of discovered misconduct.

3. *Status effects.* Future research might also investigate the status-enhancing versus status-destroying effect of director involvement in misconduct. That is, are high-status directors tainted by wrongdoing relegated to lower-status boards later on, or do they maintain the elite nature of their connections? It would be interesting to observe how these relationships might be moderated by the director's role on the board, and whether or not they remain at or depart from the stigmatized organization. Do executives and board members associated with a corporate scandal continue to be invited to prestigious gatherings of other elites like exclusive conferences or professional society/policy meetings? Are political and other social ties affected (lobbying activity, access to political and government leadership, etc.)? Research might also simply study the effect of being associated with corporate misconduct on an individual's media prominence. Controlling for coverage that directly results from the misconduct, do these individuals experience changes in the number of media mentions, appearances, or quotes?

One stumbling block to this research is that it is difficult to measure director and manager status and reputation effectively, particularly in such a way as to be able to compare status before and after misconduct. To resolve this, well-known executives and directors might be subjects of existing ongoing opinion polls (similar to job approval ratings for politicians throughout their tenure), which might be conducted by survey researchers and social scientists.

4. *Disclosure effects.* Finally, we believe that an interesting follow-on from the study of top managers' reactions to misconduct might involve changes in disclosure practices in the wake of corporate misconduct. One effect of misconduct-associated stigma might be a change in how organizations and affected individuals approach publicity and media. For example, stigmatized executives might

engage in potential retaliation against the social control agents that label and publicize the wrongdoing by granting them less access to interviews. How do organizational elites' relationships with regulatory agencies, reporters, analysts, and other watchdogs change after misconduct is revealed? Whether they remain at the stigmatized organization or move to a new one, executives associated with corporate misconduct may become more closed, revealing less information at quarterly earnings calls, for example. Alternatively, the stigmatized firm may change its disclosure practices as well; subsequent organizational disclosure (e.g., public filings, shareholder letters) may change in scope, tone, or character as a result of the misconduct. A better understanding of how disclosure practices of both organizations and affected individuals change in response to wrongdoing could provide insight into the group dynamics among organizational elites, the ways in which they make sense of negative events, and the relationships among different corporate stakeholder groups.

Impact of misconduct on the organizational rank and file. Building on our results with respect to top management teams and directors, future research might ask questions about the impact of organizational wrongdoing on lower-level employees. In other words, what happens to non-elite individuals also associated with the misconduct? Four specific areas of research inquiry in this area seem particularly fruitful.

1. *Rank-and-file turnover.* One potentially productive stream of research might focus on employee turnover as an indicator of stigma-by-association at all levels of the organization. Turnover effects on elites are relatively well understood; less well understood is the effect further down the organization. Are middle managers and lower-level employees more likely to seek other employment following instances of organizational misconduct, even if they weren't directly involved? How are they received on external labor markets: do they move to lower-status firms and are they paid less than they were at their starting positions?

Whereas the questions above might be answered through archival research, another set of questions might be better suited to laboratory experiments or audit studies. For example, researchers could study how potential employers interpret job applicants' prior history with misconduct firms. Research in this area might even

provide a setting in which it is possible to distinguish the signaling and symbolic accounts; by asking experimental subjects questions about their attributions, researchers might be able to disentangle the effects of signaling proposed by the *ex post* settling up mechanism from those of stigma avoidance forwarded by the symbolic management mechanism.

2. *Identity management.* Researchers could approach the study of individual stigmatization by taking a cue from the research on normalizing dirty work. Ashforth et al. (2007) study the way managers handle both being tainted themselves and the tainting of their subordinates. Following this logic, future research might seek to better understand the effects of misconduct on lower-level organizational employees by exploring the cognitions through which managers and employees process and make sense of working for an organization that has transgressed.

Another related approach might be to focus on group-level strategies for confronting stigma through identity management, building on the work of Blanz et al. (1998), or what Schwalbe and Mason-Schrock (1996) refer to as "oppositional identity work." Both individual- and group-level cognitive processes for dealing with transgressions could be explored from the perspective of actors actively dealing with transgressions, rather than those dealing with inherently tainted identities. In other words, what difference does it make if the stigma is unexpected and arises from organizational misconduct, as opposed to the stigma generally associated with a particular profession or sector? In particular, a promising line of inquiry might start with exploring voluntary manager and employee turnover following transgressions relative to those before the misconduct was uncovered.

3. *Workplace motivation.* Relatedly, further research might specifically address how organizational misconduct impacts prosocial behavior and individual job performance (Grant 2007; Spreitzer and Sonenshein 2004). Are the employees that stay with a tainted firm more likely to engage in positive changes to set the organization on a path of righteousness, or do they "check out" and stick strictly to their job descriptions? In performing their daily tasks, do they strive for constant improvement, with the goal of improving overall organizational performance and rebuilding firm reputation? What are the individual characteristics that lead to these differential

responses? These questions might be addressed experimentally, through vignette studies, or ethnographically, following Petriglieri (2011).

4. *Different misconduct, different effects.* Finally, we propose that organizational performance and the differing character of the misconduct itself might moderate many of the relationships proposed here, especially on lower-level employees. For example, the likelihood of employee turnover may vary depending on the type of misconduct the firm has been involved in. Misconduct stemming from attempts to hide poor performance might impact lower-level employees differently than misconduct that is more easily associated with opportunistic behavior of the firm's top managers. Furthermore, employee commitment may be attenuated when organizational problems only begin to emerge once the misconduct has been revealed, and these tensions may be exacerbated by the structural changes enacted in response to the misconduct and its aftermath. These research topics could be addressed through a mix of experimental studies and survey research.

Conclusion

Our goal in this chapter is twofold: first, to summarize the state of the literature linking individual outcomes to organizational misconduct, and second, to propose areas of inquiry that move us beyond the well-trodden soil of organizational elites' labor market penalties, and the tension between the signaling and symbolic management accounts of the process through which such consequences are allocated. The body of work on organizational misconduct is substantial and wide-reaching, yet the most thoroughly studied aspects of the consequences of organizational wrongdoing for individuals deal predominantly with financially oriented misconduct and its effects on top managers and directors, with a particular focus on turnover and compensation. Most studies focus on the signaling account or the symbolic management account in isolation, whereas most likely, there is an element of both processes at work in the allocation of consequences for the majority of individuals; achieving a research design that can identify each discrete effect is challenging.

Significant opportunities for the advancement of knowledge include the effects (both first order and beyond) on rank-and-file individuals (essentially all individuals outside the top management team and the board) who have been associated with or affected by organizational wrongdoing, and on the second-order (and beyond) consequences to all individuals including top managers and board members as well as the rank and file. These two broad research avenues indicate promising areas of inquiry in this field. We believe that there is tremendous room for theorizing and empirically testing the interplay between individual level cognitive and motivational processes, for example, and negative events at the organizational level. How employees react to the revelation that they have been working among unethical colleagues – or worse, for ethically challenged organizations – seems ripe for informative and relevant meso-level research. Moving beyond what we have suggested here, one can imagine studying the long-term performance consequences of organizational misconduct, mediated by the individual-level reactions we have proposed.

In addition, we hope to inspire further research into the consequences of misconduct for organizational elites. Whether the mechanism at play is one of signaling or symbolism, the implications are real. People's careers are likely to be affected, with spillover effects to the organizations with which these elites engage. We call for rigorous investigation of these pragmatic yet theoretically interesting phenomena.

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15 | Organizational wrongdoing and media bias

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Introduction

A social constructivist view of wrongdoing conceives organizational transgressions as the result of a two-way interaction between organizations and observers (Becker 1963; Greve, Palmer, and Pozner 2010). This view suggests that judgment determines whether organizational actors have crossed a fuzzy line separating right from wrong. This requires collecting, interpreting, and evaluating information that is sometimes ambiguous and conflicting, from many sources with varying credibility. Observers include governmental bodies, the state, professional associations, and organizational managers acting as authoritative social control agents that have formal authority to monitor individual and organizational behavior, evaluate transgressions, and impose sanctions when appropriate. Observers may also be stakeholders and members of the public who have little formal authority, yet have a direct or indirect interest in an organization's activities. These include interest groups, rival organizations, customers, suppliers, and informed private citizens. These groups form an expansive audience that consumes information about transgressions, and formally and informally influences opinions, decisions, and even the rules of social control agents who depend on the public for legitimacy. A constructivist view of wrongdoing thus recognizes that major organizational transgressions involve complex webs of public and private orderings.

Media organizations help coalesce these groups by serving as information intermediaries, collecting, interpreting, and distributing

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