Corporate Governance in the Context of Crises: Towards a Stakeholder Theory of Crisis Management

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In this paper, we take a step towards developing a stakeholder theory of crisis management. We argue that, in the context of crises, adopting the principles of a stakeholder model of corporate governance will lead companies to engage more frequently in proactive and/or accommodating crisis management behaviour even if these crisis management behaviours are not perceived to maximize shareholder value. We also propose a mechanism that may explain why the stakeholder model may be associated with more successful crisis management outcomes. We conclude by challenging the efficacy of the shareholder view in crisis and crisis-like situations, and call for further theoretical and empirical research.

1. Introduction

A common element of all crises is that they can harm organizational stakeholders such as consumers, employees, nearby communities, and the natural environment (Mitroff, Pearson, & Harrington, 1996, pp. 7–8). Inevitably, crises focus attention on corporate public, social, economic, legal, and ethical responsibilities (Carroll, 1979, p. 500; Jones, 1980, pp. 59–60; Pauchant & Mitroff, 1992, p. 184; Preston & Post, 1975; Wood, 1991, p. 697), and raise questions about ‘how corporations should be governed and managers ought to act’ (Freeman, 1994, p. 413).

Following Daily, Dalton, and Cannella (2003, p. 371), we define corporate governance as ‘the determination of the broad uses to which organizational resources will be deployed and the resolution of conflicts among the myriad participants in organizations’. In the context of crises, which organizational resources will be used and how will conflicts among stakeholders be resolved? In other words, how should corporations be governed in the context of crises? Although these questions are important, scholars acknowledge that they know little about corporate governance approaches that enable firms to prevent crises from happening or to recover from them successfully (Daily, Dalton, & Cannella, 2003, p. 378). The traditional model of corporate governance, i.e., ‘the corporation as a shareholder value maximizing entity’ (Sundaram & Inkpen, 2004a, p. 352), emphasizes contractual relations (Bradley, Schipani, Sundaram, & Walsh, 1999, p. 35), and presumes that ‘contracts can be written to contemplate all possible contingencies’ (Bradley et al., 1999, p. 38). Although the traditional or shareholder model seems to dominate corporate governance scholarship and practice (Bradley et al., 1999; Margolis & Walsh, 2003, p. 271), it has been criticized because it fails to cover situations (e.g., crises) where creating complete contracts is inefficient or impossible,
and/or the contracts between parties harm those whose participation in contracts is impractical (Bradley et al., 1999, p. 39). As Bradley and colleagues ask, ‘how could the victims of the Bhopal disaster have anticipated the actions taken by the employees of Union Carbide and ex ante contracted with the company to obtain insurance or taken sufficient precautions to prevent such an accident from occurring?’ (Bradley et al., 1999, pp. 39–40). These criticisms are important, because crises often raise questions about corporations’ and managers’ legal and ethical responsibilities towards stakeholders, and the shareholder model does not address fully what efficient and ethical corporate governance should look like under crisis conditions, when some stakeholders are victimized, and the interests and concerns of others change drastically.

We propose that a greater emphasis on the stakeholder model of corporate governance may help firms prevent crises or recover from them more successfully. Scholars have argued that an organization’s ability to prevent or effectively respond to a crisis depends on the accuracy of that organization’s assumptions and knowledge concerning its stakeholders’ behaviour in the context of crises (Mitroff & Kilmann, 1984; Nathan & Mitroff, 1991, p. 164, 179; Pearson & Clair, 1998, p. 72; Perrow, 1999, p. 154; Ulmer, 2001, pp. 610–611). In the context of crises, the stakeholder model offers a more accurate understanding of organizational stakeholders than that of the shareholder model for several reasons. Specifically, whereas the shareholder model focuses on shareholder value maximization through contracts that include those whose inclusion in contracts is efficient or practical, the stakeholder model of corporate governance emphasizes the intrinsic value of all stakeholder claims (Donaldson & Preston, 1995, p. 67, 74). Moreover, the stakeholder model recognizes a wider range of stakeholder behaviour than the shareholder model (Rowley & Moldoveanu, 2003), offers heuristics for understanding how managers identify and prioritize stakeholders in crisis and non-crisis situations (Freeman, 1994, p. 411; Mitchell, Agle, & Wood, 1997, p. 853), and gives systematic accounts of how and why stakeholders may influence corporate behaviour (Freeman & Evan, 1990, p. 354; Frooman, 1999, pp. 202–203; Frooman & Murrell, 2005; Rowley & Moldoveanu, 2003; Sharma & Henriques, 2005). Finally, the stakeholder model emphasizes the importance of developing trusting and cooperative relationships with stakeholders (Jones, 1995), and provides frameworks for describing how corporations manage, balance, and respond to the simultaneous needs of multiple stakeholders (Freeman & Phillips, 2002, p. 334; Rowley, 1997, p. 907).

In this paper, we aim to make several contributions to previous corporate governance, stakeholder theory, and crisis management research. First, we propose that, in the context of crises, adopting the stakeholder model approach to corporate governance may be associated with higher frequencies of proactive and accommodating crisis management behaviour even when doing so is not perceived to maximize shareholder value. Second, we suggest a robust mechanism that explains why, in the context of crises, the stakeholder model approach to corporate governance may result in more successful crisis management outcomes such as early detection of warning signals, minimal downtime, and effective containment of damage than the shareholder model. Specifically, we propose that developing trusting and cooperative relationships with stakeholders enable the organization and its stakeholders to prepare and respond to crises more efficiently, effectively, and ethically than adhering to contracts or the principle of shareholder value maximization. We also suggest that the stakeholder model may be the more fruitful corporate governance model for the firm and its stakeholders not only in contexts of crises but also in complex situations or crisis-like contexts such as layoffs, relocations, mergers, acquisitions, or hostile takeovers.

Our paper is organized in four parts. First, we review theoretically relevant aspects of the crisis literature; we define crisis, and review typologies of crisis management behaviour. Second, we draw on Mitchell, Agle, and Wood’s (1997) stakeholder identification and salience framework to understand how crises may change drastically the interests and salience of various stakeholders. Third, we compare and contrast the shareholder and stakeholder models in terms of their implications for crisis management behaviour and outcomes. Finally, we provide some insights into the ‘corporate objective’ debate (Sundaram & Inkpen, 2004a).

2. Towards a stakeholder theory of crisis management

2.1. A brief review of the crisis literature

2.1.1. Definition of crisis

Pearson and Clair define organizational crises as ‘low-probability, high-impact situations that [are] perceived by critical stakeholders to threaten the viability of the organization and that [are] subjectively experienced by these individuals as personally and socially threatening’ (Pearson & Clair, 1998, p. 66). This definition acknowledges that crises are ‘characterized by ambiguity of cause, effect, and means of resolution’ (Pearson & Clair, 1998, p. 60), and that stakeholders often define crises in different ways, i.e., ‘stake’ is in the eye of the stakeholder (Mitroff, Alpaslan, & Green, 2004, p. 175). This is important because a key insight of crisis research is that an organization’s assumptions and understanding of its stakeholders’ behaviour shape that organization’s

2.1.2. Crisis management
Crisis management involves two broad phases. In the preparation phase, organizations aim to identify and interact with stakeholders and/or potential victims to prevent crises from happening and affecting stakeholders (Pearson & Clair, 1998, pp. 60–61, 66; Shrivastava, 1993, pp. 30–31). In the response phase, organizations aim to minimize stakeholders’ losses that result from crises (Pearson & Clair, 1998, p. 61, 66; Shrivastava, 1993, pp. 30–31). An organization’s behaviour towards stakeholders during the preparation and the response phases of crisis management may range from denial (and hence no preparation), forced compliance, and voluntary compliance to going beyond legal expectations and making extra efforts (Shrivastava & Siomkos, 1989, p. 26). This conceptual scheme is consistent with the fourfold typologies provided by other researchers: deny responsibility, admit responsibility but fight it, accept responsibility, anticipate responsibility (Clarkson, 1995, pp. 108–109); fight all the way, do only what is required legally, be progressive, lead the industry (McAdam, 1973 as quoted in Carroll, 1979, p. 502); reaction, defense, accommodation, proaction (Jawahar & McLaughlin, 2001, p. 411).

Organizations may behave proactively, accommodatingly, defensively, or reactively both in the response phase and the preparation phase. For example, a proactive stance in the preparation phase of a crisis may involve making extra efforts to prepare for a great variety of crises and to involve in crisis preparations those stakeholders that may be harmed by organizational decisions and actions, whereas a proactive stance in the response phase of a crisis may involve telling the truth to prevent the crisis from triggering a chain reaction of other crises (see Mitroff & Anagnos, 2001, pp. 55–79). Similarly, a reactive stance in the preparation phase of a crisis may involve denying the possibility of a particular crisis or its potential effects on the firm and its stakeholders, whereas a reactive stance in the response phase of a crisis may involve denying responsibility for the effects of a crisis on victims. Table 1 provides examples of different crisis management behaviour (reactive, defensive, accommodative, and proactive) in both the preparation and response phases of crisis management.

2.2. Crises and the dynamic nature of stakeholder salience
Crises may drastically change the salience of affected stakeholders, which is defined as ‘the degree to which managers give priority to competing stakeholder claims’ (Mitchell et al., 1997, p. 869, 870). According to (Mitchell et al. (1997), stakeholder salience is shaped by at least three attributes: power, legitimacy, and urgency. For instance, a stakeholder has ‘power’ if they can get the focal firm to do something that the focal firm would not have done otherwise (Mitchell et al., 1997, p. 869). A stakeholder has ‘legitimacy’ if its actions and claims on the focal firm are generally and by

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<th>Crisis management behaviour</th>
<th>Preparation phase</th>
<th>Response phase</th>
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<tr>
<td>Reactive</td>
<td>Deny the possibility of a particular crisis</td>
<td>Deny any responsibility for the crisis and its effects on stakeholders</td>
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<td></td>
<td>Deny the potential effects of a crisis on the firm and its stakeholders</td>
<td>Be uncooperative, hide the truth, shut all communications</td>
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<td>Defensive</td>
<td>Perform cost–benefit analyses, and prepare only for crises with high expected cost to the firm</td>
<td>Admit some responsibility for the crisis but fight it</td>
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<td>Involve stakeholders in crisis preparations, only if mandated by law</td>
<td>Comply when forced, and do only what is mandated by law</td>
</tr>
<tr>
<td>Accommodative</td>
<td>Accept the possibility of the crisis and its effects both on the firm and on a broad set of stakeholders</td>
<td>Accept responsibility for the crisis</td>
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<td></td>
<td>Involve in crisis preparations a broader set of stakeholders than mandated by law</td>
<td>Voluntarily attend to the needs of the victims, and tell the truth as you know it</td>
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<td>Proactive</td>
<td>Develop mutual trust and cooperation based relationships with all stakeholders</td>
<td>Anticipate that the crisis may trigger a chain reaction of other crises</td>
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<td></td>
<td>Try to involve in crisis preparations all stakeholders that may be harmed by organizational decisions and actions</td>
<td>Get the worst about yourself out on your time before the media dig it</td>
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the focal firm perceived as appropriate or desirable within a socially constructed social system (Mitchell et al., 1997, p. 866; Suchman, 1995, p. 574). Urgency exists when two criteria are met: time sensitivity and criticality (Mitchell et al., 1997, pp. 867–868). Crises meet both criteria. First, decision making during crises is characterized by time constraints (Pearson & Clair, 1998, p. 66). Any delay in attending to the claims or needs of the stakeholders who are affected by a crisis is unacceptable to stakeholders. For example, in the case of a commercial airplane crash, crash victims’ families as well as the general public would find it unacceptable if the airliner did not attend to the victims’ and their families’ needs in a time-sensitive way. Second, crises ‘threaten the viability of the organization’ and may harm organizational stakeholders (Pearson & Clair, 1998, p. 66). For example, the crash of Valujet Flight 592 killed 110 people; as a result of WorldCom’s bankruptcy, 17,000 employees lost their jobs (Mitroff, 2005, p. 193, 200). In sum, crises increase urgency or ‘the degree to which stakeholder claims call for immediate attention’ (Mitchell et al., 1997, p. 867).

Crisis or the attribute of urgency, particularly when combined with the attributes of power and/or legitimacy, may increase the salience of particular stakeholders, as well as their potential ‘influence’ on shareholder value (see Frooman, 1999; see Frooman & Murrell, 2005; Rowley, 1997; Rowley & Moldoveanu, 2003; Sharma & Henriques, 2005). A crisis-triggered increase in stakeholder salience may take at least three different forms: (1) Dormant stakeholders may become Dangerous, (2) Discretionary stakeholders may become Dependent, and (3) Dominant stakeholders may become Definitive (see Figure 1).

2.2.1. ***Dormant stakeholders may become dangerous***

‘Dormant’ stakeholders possess the attribute of power but not the attributes of legitimacy and urgency. These stakeholders may increase their salience and become ‘dangerous’ in various ways. For example, they may trigger a crisis by launching a terrorist attack, initiating a hostile takeover, or influencing the news media (see Mitchell et al., 1997, p. 875).

2.2.2. ***Discretionary stakeholders may become dependent***

‘Discretionary’ stakeholders possess the attribute of legitimacy but not the attributes of power and urgency. These stakeholders may increase their salience and become ‘dependent’ when they are victimized by a crisis. For example, Exxon Valdez oil spill turned ‘discretionary’ stakeholders such as the region’s citizens into ‘dependent’ stakeholders (Mitchell et al., 1997, p. 877).

2.2.3. ***Dominant stakeholders may become definitive***

‘Dominant’ stakeholders possess the attributes of legitimacy and power, but not the attribute of urgency. These stakeholders may increase their salience and become ‘definitive’ when the firm is hit by a crisis. For example, if the firm goes bankrupt as a result of a financial crisis, dominant stakeholders such as bondholders or creditors become definitive stakeholders whose interests supersede, according to courts, even those of the shareholders (Blair, 1995).

2.3. **Corporate governance and crisis management**

The primary task of managers is to contract, on behalf of the firm, with stakeholders (Jones, 1995, p. 408). However, crises may drastically alter a stakeholder’s salience and potential influence on shareholder value in ways that the organization may not predict and which would not be covered by extant contracts. Thus, managerial tasks also include identifying potential/actual corporate stakeholders to a crisis and their concerns and interests, and involving these stakeholders in crisis preparation and response. Note that although crises may increase the salience of a particular stakeholder, managerial values moderate managers’ perception of that stakeholder’s salience (Agile, Mitchell, & Sonnenfeld, 1999, pp. 510–512; Hambrick & Mason, 1984; Mitchell...
et al., 1997, pp. 871–872). Assuming that top managers’ values reflect the values of the firm (Jones, 1995, p. 408), we argue that the corporate governance perspective valued and adopted by firms influences the managers’ perception of stakeholder salience, and thus their crisis management behaviour.

Scholars identify two general models of corporate governance: the shareholder model, which focuses on shareholder value maximization within legal limits (see Friedman, 1970; see Jensen, 2002; Jensen & Meckling, 1976; Vidaver-Cohen, 1998, pp. 395–397), and the stakeholder model, which focuses on the legitimate interests of ‘any group or individual who can affect or is affected by’ the corporation (Donaldson & Preston, 1995; Freeman, 1984, p. 46; Freeman, Wicks, & Parmar, 2004, p. 365; Mitchell et al., 1997, p. 856; Vidaver-Cohen, 1998, pp. 395–397). The shareholder and stakeholder models have different ‘normative cores’ (Freeman, 1994, p. 413), and differing assumptions about the corporate objective and corporate governance (Freeman et al., 2004; Sundaram & Inkpen, 2004a; Vidaver-Cohen, 1998, p. 397).

In the following sections, we describe these two models, and their underlying assumptions and normative cores in greater detail.

2.3.1. Shareholder model
According to the shareholder model, firms should have a single objective, and within legal constraints, managers ‘should make all decisions so as to increase the total long-run market value of the firm’ (Jensen, 2002, p. 236). The shareholder model is grounded in the idea that shareholders are residual risk bearers and residual claimants, and thus are motivated to ensure that the company manages its assets and resources efficiently and effectively (Blair, 1995, pp. 20–21; Easterbrook & Fishcel, 1991, pp. 67–68). Accordingly, organizations ought to be governed to maximize shareholder value (Vidaver-Cohen, 1998, p. 395) because society’s resources are utilized in the most efficient and effective way when managers concentrate their resources and attention on maximizing shareholder value (Friedman, 1970, p. 32). The shareholder model resonates with ‘strategic stakeholder management’ in which stakeholders are included in a firm’s decision-making process only if attention to stakeholders maximizes shareholder value (Berman, Wicks, Kotha, & Jones, 1999, pp. 491–492). It also resonates with ‘instrumental ethics’ which advocates employing ‘good ethics’ as a means to increase shareholder value (Quinn & Jones, 1995, pp. 22–23).

The main premise of the shareholder approach to crisis management is the following: A stakeholder should be considered in crisis preparation and response if the stakeholder has or is foreseen to have a significant influence on shareholder value. Thus, these managers behave reactively when they are dealing with non-stakeholders, i.e., entities or persons who currently are not perceived to affect or be affected by the actions of the organization until a crisis turns them into stakeholders. These managers try not to waste time and resources to include non-stakeholders in crisis preparation and response when they are perceived to have no salience, i.e., they possess none of the attributes of power, legitimacy, or urgency, and to have no influence on shareholder value. Managers behave defensively when they are dealing with a dormant (power but no urgency or legitimacy), demanding (urgency but no power or legitimacy), or discretionary (legitimacy but no power or urgency) stakeholder. These managers tend to fight all the way until they are forced to pay attention to a dormant, demanding, or discretionary stakeholder, and when they do, they admit responsibility only for doing the legally required minimum or fulfilling contractual obligations. Discretionary stakeholders are often ignored because they lack power and urgency, and are unlikely to influence shareholder value significantly unless they acquire at least one of these two missing attributes. Dormant stakeholders are often ignored because the probability of a crisis caused by a dormant stakeholder is low, and even when the probability of such a crisis is relatively higher (e.g., wildcat strikes), dormant stakeholders are less likely to influence shareholder value significantly unless they also acquire the attribute of legitimacy. Demanding stakeholders such as picketers are often ignored because they lack both power and legitimacy. In contrast, organizations behave accommodatingly when they are dealing with a dominant stakeholder (e.g., significant creditors), because a dominant stakeholder has both the legitimacy and the power to influence shareholder value. These managers may voluntarily include a dominant stakeholder in crisis preparation and response. They may behave accommodatingly also when they foresee that a dependent stakeholder can acquire power, and a dangerous stakeholder can acquire legitimacy. Managers may behave proactively when they are dealing with a definitive stakeholder that possesses all three attributes of power, legitimacy, and urgency, and thus has a significant influence on shareholder value. Managers may behave proactively also when they foresee that a dominant stakeholder can acquire the attribute of urgency. They may anticipate responsibility and make extra efforts to include these stakeholders in crisis preparation and response.

Exxon’s handling of the oil spill exemplifies the shareholder model of crisis management: When oil prices changed suddenly, Exxon management decided to reduce safety and maintenance cost because they believed that the likelihood of a major spill in the Bay of Valdez was ‘only once in 241 years’ (Bowen & Power, 1993, p. 100; Mitroff & Pauchant, 1990, p. 7), and...
perceived environmentalists and the region’s citizens as discretionary stakeholders with no urgent claim or power to influence shareholder value (Mitchell et al., 1997, p. 877). Exxon management, however, was forced to pay more attention to these stakeholders when they first became dependent stakeholders as a result of the oil spill, and then became definitive stakeholders when their power to influence shareholder value was provided by the Alaskan government and the court of law (Mitchell et al., 1997, p. 877).

2.3.2. Stakeholder model

According to the stakeholder model, all stakeholders have intrinsic value (Donaldson & Preston, 1995, p. 67, 74). Thus, firms should have multiple objectives and managers ‘should make decisions so as to take account of the interests of all the stakeholders’ (Jensen, 2002, p. 236; Vidaver-Cohen, 1998, p. 397). Increasing shareholder value is only one of the multiple objectives of the stakeholder model (Jones, Wicks, & Freeman, 2002, p. 26; Maren & Wicks, 1999, p. 289). The stakeholder model recognizes the idea that shareholders, being protected by ‘limited liability’, are often not the only residual claimants (Blair, 1995, p. 27, 238). It resonates with the ‘principle of fairness’: Less powerful stakeholders (e.g., discretionary and dependent stakeholders) that may be harmed must have the right to be included in corporate governance (Donaldson & Dunfee, 1994, p. 260; Phillips, 1997, p. 57; Van Buren, 2001, p. 494). It also resonates with ‘intrinsic stakeholder commitment’ in which stakeholders are included in a firm’s decision-making process because the firm has moral commitments to stakeholders (Berman et al., 1999, pp. 492–494), and with ‘non-instrumental ethics’ which advocates that ethics is an end in itself, and when shareholder interests and moral principles conflict, moral principles should dominate (Quinn & Jones, 1995, p. 23).

The main premise of the stakeholder approach to crisis management is the following: The decision to include a stakeholder in crisis preparation and response should not be based solely on that stakeholder’s salience or influence on shareholder value. For example, the stakeholder model requires that managers pay attention to a particular stakeholder to the extent that stakeholder is actually or potentially at risk of harm or injury caused by their organization’s decisions and actions. As Donaldson and Preston put it, within 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 & Preston, 1995, p. 85, emphasis added). Moreover, ‘the interests of all stakeholders have intrinsic value, and no set of interests is assumed to dominate the others’ (Clarkson, 1995; Donaldson & Preston, 1995; Jones & Wicks, 1999, p. 207). This premise does not imply that all stakeholders are equal, or that their interests are equally legitimate (Donaldson & Preston, 1995, p. 67; Phillips, 1997, p. 63). Rather, it suggests that, in the context of crisis preparation and response, the interests of potential/actual victims or low-salience stakeholders may sometimes dominate shareholders’ interests. Thus, managers or organizations behaving more in accord with the principles of the stakeholder model aim to behave proactively or at least accommodatingly when dealing with both high salience (e.g., definitive), low salience (e.g., discretionary), and ‘derivatively legitimate’ (Phillips, 1997, p. 63, 2003a, pp. 34–35; Phillips, 2003b, p. 119) (e.g., dangerous) stakeholders. These managers will tend to make extra efforts to establish trusting and cooperative relationships (Jones, 1995) with a broad set of stakeholders, and increase their awareness as to how different stakeholders may be affected by and respond to a major crisis, even if such extra effort may not be required legally or by contracts. Similarly, in responding to a crisis, managers that adopt the stakeholder model will be more cooperative. They may try to attend to the interests of victims, and focus on the needs of affected stakeholders even when such efforts may not be required legally or contractually.

Malden Mills’ handling of the fire that destroyed its textile manufacturing plant exemplifies the use of stakeholder management strategies in corporate governance: Before the fire, which resulted in the injury of 36 people and put 3,000 employees out of work, Malden Mills had proactively developed strong relationships with its stakeholders (Ulmer, 2001, p. 597). By refusing to leave the region for cheaper labor, and developing the community over time through various activities, Malden Mills had established a positive reputation of trustworthiness, loyalty, and reciprocity among the community (Ulmer, 2001, pp. 597–598, 599–600). By cooperating with unions to make sure employees are treated fairly, and keeping its promise to hire all employees laid-off when the company almost went bankrupt, Malden Mills had established a high level of trust and loyalty between the company and its employees (Ulmer, 2001, pp. 599–600). Right after the devastating fire, Malden Mills announced to the community that the company was not going to leave the region, and it would pay employees their full salaries for as long as it could (Ulmer, 2001, p. 603, 604). Although Malden Mills accommodated the interests of the community and its employees, its decisions put a financial strain on the company, was criticized for being irreconcilable with the economics of the situation (Ulmer, 2001, p. 606). Nonetheless, for Malden Mills, maintaining the trust and loyalty-based relationships with its stakeholders was the morally responsible thing to do.
In light of the discussion above, we propose:

**Proposition 1a:** In the context of crises, managers behaving more in accord with the stakeholder model will exhibit greater frequencies of proactive and accommodative crisis management behaviour, even if these crisis management behaviours are not perceived to increase shareholder value.

**Proposition 1b:** In the context of crises, managers behaving more in accord with the shareholder model will exhibit greater frequencies of proactive and accommodative crisis management behaviour, only if these crisis management behaviours are perceived to increase shareholder value.

### 2.4. Corporate governance and crisis management outcomes

The success of crisis preparation or response efforts depends on at least two factors: the nature of an organization’s established relationship with its stakeholders, and the accuracy of an organization’s understanding of how its stakeholders might behave in the context of crises (Pearson & Clair, 1998, p. 72; Ulmer, 2001, pp. 610–611). Researchers have argued that successful crisis management outcomes such as early detection of warning signals, minimal downtime, effective containment of damage, and positive effects on corporate reputation result when the organization builds alliances, achieves coordination, and shares accurate information with its stakeholders (Pearson & Clair, 1998, p. 68, pp. 72–73). In this section, we suggest an explanation for why, in the context of crises, the fundamental principle of the stakeholder model, that all stakeholders have intrinsic value, facilitates the forming of alliances and the sharing of accurate information with the organization’s stakeholders, and hence, coordinates the organization’s and its stakeholders’ crisis preparation and response more efficiently and effectively than relying on contracts or the fundamental principle of the shareholder model, ‘shareholder value maximization’.

In non-crisis or normal times, the interests, preferences, and concerns of stakeholders are relatively stable. Thus, writing efficient contracts with stakeholders is at least a potentially tractable problem. Because crises are complex, ‘messy’ situations (Mitroff et al., 2004), analysing and strategizing about the many complex ways that crises may affect shareholders, and including these contingencies in a contract is an impossible task at worst and a daunting and costly task at best. Managers adopting the shareholder model must have knowledge of relevant facts regarding crises and their direct/indirect influence on shareholders for the shareholder model to lead to successful crisis management outcomes and increased shareholder value. Furthermore, these managers must be able to collect, analyse, and process all this information without a broad set of stakeholders providing specific localized information about their interests, preferences, and concerns. Without the input and support of the stakeholders involved, managers may fail to write efficient contracts, or efficiently process and analyse all of the relevant information about stakeholders’ particular interests, identities, and risks and their potential influence on shareholder value. As such, and perhaps ironically, in contexts of crisis, the shareholder model resembles a centrally planned economy (see Hayek, 1945), where managers are asked to conduct enormously difficult and quick analyses and interpretations of local conditions without the information and knowledge of local participants or stakeholders. Moreover, such analysis of stakeholders’ demands from the focal organization is sometimes less critical, if not irrelevant, because contrary to the shareholder model’s underlying assumption that stakeholders aim to maximize their economic utility, stakeholders may be motivated just to express or reinforce their identity, even when their behaviour fail to further their interests (Rowley & Moldoveanu, 2003, p. 205, 215). This argument may be true particularly in the context of crises, where stakeholders may have multiple stakes (Acquier, Gand, & Szpirglas, 2008), experience the crisis subjectively, and demand behavioural as well as emotional responses targeted at their recovery (Pearson & Clair, 1998, p. 66).

The more efficient approach to crises requires including as many stakeholders as possible in crisis preparation and response, and allowing them to bring their perspective, identity, and knowledge to the analysis (Nathan & Mitroff, 1991, p. 164, 179; Pearson & Clair, 1998, p. 72; Perrow, 1999, p. 154; Ulmer, 2001, pp. 610–611). Thus, as much as prices coordinate the actions of different agents in situations characterized by uncertainty about relevant facts (Hayek, 1945), recognizing the intrinsic value of all stakeholders and treating them as such may coordinate the actions of different stakeholders in situations characterized by uncertainty about relevant identities, interests, and risks. Where the pursuit of self-interests and reactions to local prices may coalesce into global collective efficiencies, so too the recognition of all stakeholders’ intrinsic value and acting upon it may coalesce into global collective efficiencies, because managers’ and stakeholders’ mutual and sincere treatment of each other, and their relationships based on trust and cooperation (see Jones, 1995), may produce local and fast decisions that solve inherent problems of coordinated action in the context of crises. In a sense, in the context of crises, managers adopting the stakeholder maximization model operate as a planned economy, whereas managers adopting the stakeholder model allow for the
Managers who behave more in accord with the shareholder model aim to maximize shareholder value. They involve a narrow but presumably optimum set of stakeholders in crisis plans and procedures. These managers tend to define crisis from the shareholders' viewpoint. As a result, certain crises and low salience stakeholders that are perceived not to influence shareholder value rarely show up on the radar screen or are identified by their interests in the corporation, or stakeholders, reported safety problems with the DC-10 aircraft cargo doors, McDonnell Douglas ignored the early warning signal of the impending crisis, and moreover, through a contract, prevented this information from reaching the right stakeholders, and thus hinder both crisis prevention and crisis recovery. When Convair, one of McDonnell Douglas' contractors or stakeholders, reported safety problems with the DC-10 aircraft cargo doors, McDonnell Douglas ignored the early warning signal of the impending crisis, and moreover, through a contract, prevented this information from reaching the Federal Aviation Administration, an important stakeholder (Rowley, 1997, pp. 891–892). Shortly after FAA certification, a DC-10 crashed because of a cargo door problem, and harmed multiple stakeholders. In short, managers adopting the shareholder model may be prepared for a limited variety of crises, fail to secure critical resources or information from many of its stakeholders, and may hinder the flow of critical information or resources among these stakeholders.

Managers who behave more in accord with the stakeholder model, try to recognize and acknowledge the intrinsic value of all stakeholders. These managers aim to prepare for a great variety of crises and establish relationships with a broader set of stakeholders. The stakeholder model acknowledges that, ‘stakeholders are identified by their interests in the corporation, whether the corporation has any corresponding functional interest in them’ (Donaldson & Preston, 1995, p. 67). Thus, these managers are able to define crisis from others’ or different stakeholders’ viewpoint. The stakeholder model also acknowledges the ‘principle of fairness’ (Donaldson & Dunfee, 1994, p. 260; Phillips, 1997, p. 57; Van Buren, 2001, p. 494), and aims to include less powerful stakeholders in crisis management efforts. These strategies allow managers to develop a more realistic understanding of themselves and the environment (Nathan & Mitroff, 1991, p. 164, 179; Perrow, 1999, p. 154). As a result, these managers can pick up and interpret adequately early warning signals sent out by different stakeholders and crises (Clair, 1993; Nathan & Mitroff, 1991, p. 164, 179), and institute a wide variety of damage containment mechanisms in advance of the occurrence of crises (Pearson et al., 1997, p. 56). Moreover, cooperating with a broad set of stakeholders in crisis preparation and response increases the availability of critical stakeholder resources and information. These managers’ emphasis on morality, fairness, and acknowledging the intrinsic value of all stakeholders makes these managers more trustworthy and cooperative in the eyes of their stakeholders (see Jones, 1995). Specifically, establishing strong and sincere relationships with stakeholders before a crisis makes crisis prevention and recovery faster and easier, because such efforts make stakeholders less likely to withhold resources and information, or to employ ‘coercive’ manipulation strategies restricting usage of resources before and after crises (Frooman, 1999, pp. 196–197; Frooman & Murrell, 2005; Ulmer, 2001, pp. 610–611).

Managers who behave more in accord with the stakeholder model, recognize their dependence and moral commitment to a broad set of stakeholders. These managers negotiate and develop collaborative strategies with their stakeholders (Nathan & Mitroff, 1991, pp. 169–171). These strategies include forming cross-functional crisis management teams that facilitate the representing of internal and external stakeholders (Mitroff et al., 1996, pp. 12–13; Pearson et al., 1997, pp. 60–62; Pearson & Mitroff, 1993, pp. 56–57), integrating stakeholders to organizational crisis management systems and structures (Mitroff et al., 1996, p. 27, 117), and sharing accurate information with stakeholders (Pearson & Clair, 1998, p. 73; Ulmer & Sellnow, 1997, 2000). In short, the stakeholder model allows managers to prepare for a wide variety of crises, enjoy access to the resources of a broad set of stakeholders, and facilitate the flow of critical resources or information among stakeholders.

To summarize, although a stakeholder model approach to crisis management requires more time and resources invested in crisis management as well as developing stakeholder relationships based on trust and cooperation, managers following the principles of this model are more likely to avert crises and their costly consequences such as lawsuits and bankruptcy. Because these managers are considered by their stakeholders fair, trustworthy, and cooperative, they enjoy greater levels of access to critical information and
stakeholder resources. Managers of these organizations and their stakeholders perform more effectively the complex and coordinated activities required in the heat of a crisis, and respond quickly and effectively to each other’s differing needs or interests. Thus, we propose:

Proposition 2: In the context of crises, managers behaving more in accord with the stakeholder model will enjoy more successful crisis management outcomes (such as early detection of warning signals, fast recovery, etc.) than managers behaving more in accord with the shareholder model.


Johnson & Johnson’s handling of the Tylenol crisis offers an example of successful crisis management. When the crisis hit and resulted in the death of several people, Johnson & Johnson executives were concerned with the safety of consumers (Mitroff & Anagnos, 2001, pp. 13–18). The executives knew that a recall would cost enormous sums of money, and cause a drop in share price. Nonetheless, Johnson & Johnson executives not only accepted but also anticipated responsibility. Thus, they recalled Tylenol products, and disclosed honestly their knowledge of the case to the media and the public (Mitroff & Anagnos, 2001, pp. 13–18). Johnson & Johnson executives were cooperative. Although Johnson & Johnson suffered a sharp drop in its stock price, the company’s stakeholder approach to crisis management reinforced its reputation for trustworthiness (Fink, 1986; Mitroff & Anagnos, 2001; Wood, 1994), allowing the company to regain its market share and stock price in a short time (Marcus & Goodman, 1991, p. 300). That is, recognizing the intrinsic value of stakeholders resulted in more successful crisis management outcomes as well as increased shareholder value.

In contrast to the Johnson & Johnson’s Tylenol crisis, Firestone’s tire crisis provides an example of unsuccessful crisis management. The National Highway Traffic Safety Administration reported that there have been more than 150 deaths and 250 injuries in crashes involving Firestone tires (Newman, 2001). Firestone executives knew about tire safety issues long before the recall (Power & Simison, 2000), and used tire safety data to determine the effects of tread separations on profits (Newman, 2001, p. 17). They neither informed nor collaborated with key stakeholders such as consumers or the government, because doing so was not required legally (Eisenberg & Zagorin, 2000). Instead, these executives exhibited reactive crisis management behavior: they denied responsibility, blamed Ford Explorers, and held their employees responsible for the faulty tires. Firestone executives were also defensive. They did not recall the defective tires until they were forced to (Eisenberg & Zagorin, 2000; Welch, 2001). They were neither trustworthy nor cooperative. As a result, Firestone damaged its reputation. Moreover, Bridgestone (Firestone’s parent company) stocks suffered a sharp and long-term drop in world markets. That is, failing to recognize the intrinsic value of certain stakeholders and treating them as such resulted in unsuccessful crisis management outcomes and decreased shareholder value.

These anecdotes are consistent with preliminary research on the relationship of corporate governance, crisis management, and performance outcomes. For example, Frooman meta-analysed event studies of stock market reaction to industrial crises such as lawsuits and product recalls, and reported that acting in a socially responsible way is a necessary but not sufficient condition for increasing stakeholder wealth (Frooman, 1997, p. 241). Waddock and Smith conducted a responsibility audit of eight companies, and found that adoption of proactive, stakeholder inclusive, morally responsible practices, lowered costs, legal exposure, and risks to company reputation (Waddock & Smith, 2000, p. 76). Mitroff and Alpaslan reported a positive correlation between successful crisis management outcomes and proactive crisis management practices of a sample of Fortune 1,000 companies (Mitroff & Alpaslan, 2003). Sheaffer and Mano-Negrin compared 82 Israeli business firms and not-for-profit organizations, and found that firms that focused strictly on profit maximization were more prone to crisis. Their results suggest that the shareholder model is at least associated with higher frequencies of crises (Sheaffer & Mano-Negrin, 2003).

2.5. Implications for the ‘Corporate Objective’ debate

Crises raise questions about ‘how corporations should be governed and managers ought to act’ (Freeman, 1994, p. 413), and provide a theoretically interesting context for scholars to debate and examine the corporation’s objectives or goals (see Freeman, 1984; see Freeman et al., 2004; Jensen, 2002; Sundaram & Inkpen, 2004a, 2004b). The ideas presented in this paper provide insights into the ‘corporate objective’ debate. Specifically, a stakeholder theory of crisis management suggests that, in the context of crises, corporations should not pursue only the goal of shareholder value maximization. This is important because there are several crisis-like situations, i.e., situations with high ‘moral intensity’ (Jones, 1991), which involve a broad set of stakeholders. The pursuit of ‘shareholder value maximization’ may not be efficient for society in such situations either (Berle & Means, 1991; Blair, 1995;
Coffee, 1986). For example during the selling of a firm, when changes in corporate control take place, employees who have developed firm-specific skills, managers who have been compensated with seniority-based packages, and communities that have given tax-breaks to corporations in exchange for more jobs may all have unfulfilled implicit residual claims (Blair, 1995; Coffee, 1986). Thus, it may be both fair and efficient (Blair, 1995) for corporations to have multiple objectives, and to put emphasis on moral claimants, not only on 'explicit' residual claimants. In fact, in situations such as layoffs, relocations, mergers, acquisitions, or hostile takeovers, the stakeholder model may benefit both shareholders and stakeholders to a greater extent than the shareholder model. These insights challenge the efficacy of the shareholder view in contexts of crises, and call for further theoretical and empirical research.

3. Conclusion

As a result of globalization, and the growing financial, economic, technical, social, and environmental interdependencies, crises are on the rise (see Boin & Lagadec, 2000, p. 185; Mitroff, 2005, p. 12). As the interdependencies brought on by globalization and modernization increase so too will the impact of crises on stakeholders grow (see Boin & Lagadec, 2000, p. 185; Mitroff, 2005, p. 13). It seems that all kinds of organizations, business as well as governmental, and their stakeholders will experience crises on a more frequent basis (Coleman, 2006). In such a world, where crises are more frequent, the need for a stakeholder theory of crisis management is also high. The ideas presented in this paper provide a step in the development of a stakeholder theory of crisis management, and suggest that the stakeholder model may be the more fruitful corporate governance model in the context of crises.

References


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