

**FIFTEEN MINUTES OF SHAME: A MULTILEVEL APPROACH OF THE  
ANTECEDENTS AND EFFECTS OF CORPORATE ACCOUNTING SCANDALS**

**by**

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# Fifteen Minutes of Shame: A Multilevel Approach of the Antecedents and Effects of Corporate Accounting Scandals

Abstract

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The commonality of corporate scandals and the quest for who should be accountable motivates this investigation. I used a mixed method multilevel design that combines qualitative and quantitative data from organizations, executives, and capital markets, to address the research question of who is accountable in reputational scandals. The evidence suggests that reputational risk exposure increases when organizations' and executives' values are not aligned. Managers' values mediate the implementation of organizational values toward risk assessment. This counterintuitive finding suggests that securities value is not automatically depressed after scandalous events. Instead, shareholders dissipate potential doubt about the stability of firms, guided by analysts' revised expectations rather than judging ethical implications. As a consequence, executives may not face investors' disapproval, which would encourage them to focus on preventive efforts. Organizations and executives must align their ethical values to proactively protect their organizations' reputations. Financial performance indicators of firms do not influence the behavior of investors after scandals.

**Keywords:** corporate scandals; organizational values; risk assessment; reputational risks; executives' compensation; capital market response; analysts' opinions

## Executive Summary<sup>i</sup>

The commonality of corporate scandals and the quest of who should be accountable for motivates this investigation. Organizations, over time, develop as one of their most important assets, the value of their name. Companies' names can exceed three or more times their assets value. Scandals, however, only take a day to compromise what years of effort have created: a bond / trust between firms and its shareholders and stakeholders.

After these events occur, society's most important claim is who has accountability for the event. In other words, under whose shoulders the burden of the scandals should rely. This is, therefore, the research essential question. In order to address this central concern, three main questions arise. Is the organization the one who should be accountable? Is it something in the firms' machinery or a structure that expose them to reputational events scandals? But, perhaps it is not the organizations that have the responsibility, maybe the obligation relies on the individuals who are in charge of running the organizations. Or possibly, investors as owners have the real responsibility in designing the mechanisms that promote executives' diligent behavior.

To address such theoretical concerns, current theoretical frameworks present some flaws in the explanation scandals. However, they establish the foundations to deeper investigations about the phenomena. I work with a definition of scandals where these events are promoted by outsiders about an intentionally organizational behavior.

Institutional theory argues that internal structures should be designed to accomplish goals. Imitation of structures in the legitimacy quest instead of pursuing their own goals

balks its achievement. Yet, because the origin that triggers the scandals is unclear, it is not possible to assume that institutional flaws triggered the event.

The second component in the exploring the accountability issue represents the role of executives. To explain their behavior, the agent-principal literature argues that owners and executives are separate entities and their incentives differ without an aligning mechanism. However, the alignment process assumes individuals' actions are only because of economic reasons ignoring that there are other non-economic motivators that may induce executive behavior.

The last theoretical element to address the accountability concern is the capital markets participants group. The behavior in the securities affairs is explained by the efficiency in the capital markets. Investors and other related participants adjust securities prices based on expectations about firms' performance. Positive returns follow positive financial news and the opposite with negative news ones. In this sense, the assumption does not consider non-financial information released outside firms' control which is the scandals case.

For inquiry to these broad concerns, this research framework applies a mixed method design that combines two experiential components, a theoretical-emerge qualitative piece and an experimental quantitative inquire, with a quantitative archival piece with.

In the qualitative component, I follow a comparative inductive process for understanding the overall experiences of organizations dealing with reputational scandals. The methodological approach used is grounded theory based on semi-structured interviews with managers of 27 major publicly traded organizations.

The second experiential piece focuses on analyzing specific factors that enhance the likelihood of suffering a reputational scandal. I conducted an experiment research where 90

executives and 90 internal auditors had to execute a BOD recommendation facing an organizational reputational threat. The research methodology applies one-way ANOVA test where the dependent variable is the executives' response and the independent variable are the severity of the threat and expected personal losses.

The third piece is a match sample archival study that collected 96 corporate scandals and an equal number of peer industry firms. Because the goal is to understand the behavior of capital markets to a specific situation, the research methodology combines an event study with a cross-sectional multivariate analysis.

Findings from the qualitative research served as a framework in the experimental setting. Then, I validate executive responses with the qualitative research findings. Also, by selecting a specific type of scandal, I validate the qualitative findings with the archival findings. Then, I integrate the three studies' findings and triangulated them to obtain a single overall finding.

In the first qualitative research, where I address the question, what is the experience of organizations attending to and mitigating reputational threats attributable to themselves or to external parties, whether or not they are affiliated with the organization? Their responses document that not all reputational threats become scandals. In fact, they mitigate their reputational exposure by channeling resources to their governance risk assessment strategies based on the organizations' values to promptly detect the reputational threat before anyone else outside the organization does. The governance structures, in turn, rely on solid detection and monitoring control systems, the inclusiveness of the ethical control environment, and strong regulatory adherence. A scandal occurs when at least one of those elements fails and, once it does, the organization must invest additional resources in the

design and implementation of a damage-controlling management plan to minimize the associated negative effects.

The reality simulation experimental setting inquires on whether executives adequately attend to reputational threats. In order to address such concern, I hypothesize that executives will proactively react to reputational threats based on the severity of the threat. I also theorized that when the executives are mainly driven by economic incentives they will react negligent when their personal economic expectations are compromised. The theorization process concludes with an interaction term between the severity of the threat and the economic incentives in the quest for an optimal response.

Findings indicate that the severity of the reputational threat does not influence the executives' decisions and executives prefer not to deal with reputational threats when their expected personal-gains are likely to be jeopardized. But, the interaction term indicates that the severity will influence the final response when executives' personal finance is not endangered. This suggests that managers who execute the risk assessment will do so when their personal values are aligned with those of the organization and the economic incentives are less relevant than firm' reputation. Internal auditors in contrast did not show these behaviors. Their responses demonstrated an optimal risk assessment behavior unrelated with personal economic incentives.

The third study inquires in how the capital markets respond when these events occur. To understand investors' reaction, the central hypothesis argues that accounting scandals do not necessarily result in negative abnormal returns. Then, the following hypotheses center in explaining environmental and personality factors that could induce the market response under the reputational events. The environmental factor is represented by the role of analysts in the investors' decision-making process. The settlement payment to

end the investigation represents investors' beliefs. Both elements the environmental and the personal, are theorized interacting with the final investors' response to acknowledge the combined effect.

The last capital markets study findings indicate that investors' responses to scandals could also be positive. Also, evidence suggests, as theorized, that analysts revised recommendation towards buying positively influence the final response. In terms of the settlement, this component also is positively associated with the market's reaction. The interaction term also suggests a positive association. These counterintuitive findings suggest that securities value is not automatically depressed after scandalous events. Instead, shareholders dissipate potential doubts about firms' stability guided by analysts' revised expectations rather than judging the event ethical implications.

This material concludes by integrative findings of the three studies. From them, evidence suggests that reputational risk exposure increased when organizations' and executives' values are unaligned. Managers' values mediate the implementation of organizational values towards risk assessment. And, because analysts and investors' beliefs do not negatively react to scandalous news, the market value of the firm may not decrease. As consequence, executives may not find investors' disapproval that encourages them to focus on the reputational preventive efforts. Therefore, organizations and executives must align their ethical values to protect proactively their organizations' reputation. Firms' financial performance indicators do not influence investors' behavior after scandals.

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<sup>i</sup> Citations partially removed in this material. For full disclosure refer to the original printed document in the OhioLink system.