UC Irvine
UC Irvine Previously Published Works

Title
Dismissing A Tarnished Ceo? Psychological Mechanisms And Unconscious Biases In The Board's Evaluation

Permalink
https://escholarship.org/uc/item/0dj4c9mw

Authors
Wiersema, MF
Weber, L

Publication Date
2017-09-28

Peer reviewed

eScholarship.org Powered by the California Digital Library
University of California

DISMISSING A TARNISHED CEO? PSYCHOLOGICAL MECHANISMS AND UNCONSCIOUS BIASES IN THE BOARD'S EVALUATION

By

Libby Weber
Margarethe Wiersema
Merage School of Business
University of California, Irvine

DISMISSING A TARNISHED CEO? PSYCHOLOGICAL MECHANISMS AND UNCONSCIOUS BIASES IN THE BOARD'S EVALUATION

In today's frenzied media world, CEO dismissal[1] often merits front page news. Reasons for dismissal vary from lackluster performance (CEO Steve Ballmer at Microsoft), to corruption (CEO Martin Winterkorn at Volkswagen for cheating on diesel emissions), to overstating earnings (the top management team at Toshiba for overstating earnings by $1.2 billion). Prior to the 1990s, the typical CEO could look forward to an average tenure of 14 years, ending with a retirement gala and hand-selection of an heir from within the firm. Those days are long gone. CEO dismissal now accounts for 24% of succession events within the S&P 500, bringing the average tenure down to nine years in the US[2], with similar figures in European and Japanese companies.

As CEOs can have a major impact on organizations, a wealth of empirical work examines the antecedents and consequences of succession events[3]. Despite this research, our understanding of the board's decision to dismiss the CEO remains murky. For one, boards have varied responses to similar corporate misconduct or poor performance[4], with some reacting quickly with CEO dismissal and others showing far more tolerance. Further, though the board is supposed to serve as an important monitor of the firm, its independence and willingness to act can be compromised. These decisions may personally benefit directors, such as ingratiatory behavior to retain the wealth and status associated with a board seat. These deliberate influences on the board's behavior have been studied extensively, predominantly under an economic-based agency theory[5] lens, which assumes that the actors are rational and not subject to psychological biases.

However, an additional reason for the murkiness surrounding CEO dismissal that

has not been as thoroughly examined is that individual directors are boundedly rational and thus their cognitive processes are subject to contextual influences and systematic biases that may unconsciously compromise the board's fiduciary duties. As a result, viewing CEO dismissal through a psychological lens allows for a more comprehensive understanding of the board's decision to dismiss the CEO. We utilize a socio-cognitive perspective[6] which combines social and cognitive psychological lenses to examine this decision process. First, we investigate the socio-cognitive process by which stakeholders and individual directors evaluate the CEO of a firm with poor performance or accusations of misconduct. Then, we examine how these judgements are evaluated by the board and how stakeholder and claim attributes, as well as individual director's motivation plays a key role in determining the eventual outcome. Finally, we examine how contextual conditions and cognitive biases systematically influence these processes and their outcomes. Figure 1 depicts our overall model of CEO dismissal.

Figure 1 about here.

We combine expectancy violation theory[7] with attribution theory[8] to examine how individual stakeholders' biased perceptions and attributions influence the board's decision. These theories suggest that when individual stakeholders and directors perceive that corporate conduct or firm performance violates their expectations, and they attribute the misconduct to external factors, the CEO is less likely to be perceived as tarnished. In contrast, when expectations are violated and individual stakeholders and directors attribute the misconduct internally, the CEO is more likely to be perceived as tarnished. However, many other factors influence individual stakeholders' and directors' judgment

when an internal attribution occurs, such as whether the CEO's behavior is perceived as intentional or frequent, as well as the extent of the negative impact of the perceived violation. We further suggest that both contextual factors and cognitive biases systematically, influence individual stakeholders' and directors' perceptions and attributions of violations. Figure 2 displays our socio-cognitive process for stakeholders' and directors' evaluation of the CEO.

Figure 2 about here.

Once some of the firm's stakeholders and/or directors perceive the CEO is tarnished, the board must determine what to do. We propose that the firm's stakeholders are central to the board's evaluation of whether to dismiss the CEO. Additionally, board directors are bounded rationally individuals who are subject to the influence of contextual factors and cognitive biases in making this determination.

By modeling the psychological processes that shape how corporate misconduct or poor performance is perceived and evaluated, we provide a more complete understanding of why some CEOs are dismissed while others are not, even when very similar infractions occur. Our model highlights two processes, how a CEO becomes tarnished and how the board evaluates the tarnished CEO. By providing a better understanding of these processes, boards can recognize and remove biases in their deliberations, allowing it to make the most beneficial decisions for the company. Given the increasing incidence of CEO dismissal, we believe that our framework is an important contribution to both academic research and to corporate boards who face the responsibility of deciding how to respond to instances of poor firm performance and corporate misconduct.

CEO EVALUATION BY INDIVIDUAL STAKEHOLDERS AND DIRECTORS

The board's top responsibility is to hire and fire the company's CEO. However, in doing so, the board must consider those groups or individuals that have a stake in the organization. So, while a company's board formally evaluates a CEO[9], the company's stakeholders − e.g., investors, society, employees, etc. − are also central to this process. When poor performance or corporate misconduct occurs, stakeholders may perceive that their expectations were violated, triggering a search for the source of the violation. As a result, boards must be aware of individual director and stakeholder expectations, understand how perceptions of violation occur, anticipate attributions for these perceived violations, and evaluate unconscious influences on these processes.

Individual Expectations

The company's stakeholders and directors expect firm conduct and performance to fall within an acceptable range of behaviors and outcomes, based on shared understandings of appropriate behavior based on rules that are seen as "natural, rightful, expected, and legitimate".[10] Thus, expectations are developed from shared goals and incentives, prior outcomes or experiences, and rules and norms created by social institutions. Because the firm's stakeholders and directors have different experiences and perspectives, they likely hold varied expectations, which may or may not overlap and may even compete. In examining how expectations influence CEO dismissal, it is important to focus on those that are appropriate in evaluating firm conduct and performance. Thus, we focus on three types of expectations: 1) economic, 2) moral and 3) organizational[11].

Economic expectations consist of beliefs or views about the company's financial

performance and earnings prospects, commonly reflected in the company's stock price. In contrast, moral expectations are derived from social norms, laws and commonly held beliefs about acceptable and unacceptable behavior[12]. Organizational expectations reflect how firm employees, including the CEO, should behave. Individual stakeholders and directors are likely to hold different economic, moral and organizational expectations of the firm. For example, the aggressive raising of drug prices by Valeant in 2016 may violate only some stakeholders' moral expectations.

Individual stakeholder and director expectations are not static. Moral expectations, for example, are constantly evolving, such that previously acceptable actions may later be perceived as falling outside an acceptable range, and vice versa. For example, the passage of the Dodd-Frank Act in response to the financial meltdown of 2008 set higher standards for acceptable conduct by financial institutions, raising stakeholder expectations.

Individual Perceptions of Violation or Non-Violation

Individual stakeholder and director expectations serve as the standard against which corporate conduct and company performance are evaluated. Beyond a certain threshold for misconduct or firm performance, a violation for individual stakeholders or directors is triggered. This threshold is shaped by the material impact of the violation, contextual factors and individual cognitive biases, all of which are discussed below.

For example, CEO Chris Viehbacher of the French pharmaceutical company Sanofi violated directors' expectations regarding trust and communication with the board. As a result, he was abruptly fired, even though the financial community supported his strategy of making the company more global and embracing biotechnology. In making

the announcement, the chairman of the board commented that directors were deeply dissatisfied with Mr. Viehbacher's "inability to deal, exchange and examine our strategy in a confident manner with the board."[13] As this example illustrates, the firm's stakeholders can hold varied expectations, so a particular incident of misconduct or poor performance is unlikely to violate all their expectations simultaneously. The second half of our model addresses how boards evaluate these varied perceptions in detail.

Individual Attributions & Resulting Perceptions of the CEO

Cognitive psychologists have found that when an individual perceives a violation, the mismatch between performance or conduct and his expectations causes him to orient his attention towards the unexpected event[14]. This shift triggers negative emotions, which induce deep cognitive processing to determine the source of the violation[15]. In the context of stakeholders and directors evaluating CEO conduct and performance, the resulting attribution process[16] provides insight as to whether individual stakeholders or directors are more likely to perceive the company's CEO as tarnished due to a specific incident of misconduct or poor performance.

Attribution theory explains how individuals make sense of events and use information to form causal judgments[17]. When corporate misconduct or poor performance is perceived to be due to conditions or events outside of the firm, then attributions are more likely to be external, reducing the chance that the CEO is perceived as tarnished. In contrast, when internal factors are viewed as the cause of the misconduct or poor performance, the CEO is more likely to be tarnished, although this judgment may be influenced by additional factors.

When the cause of misconduct or poor performance is attributed to the CEO, intentionality of the violation influences whether he is held accountable[18]. If the CEO's conduct is perceived as unintentional, misconduct or performance is viewed as an accident rather than a deliberate act, and he is not likely to be perceived as willfully causing harm[19]. However, if misconduct is viewed as intentional, the CEO is more likely to be perceived as tarnished. The recent diesel emissions scandal of Volkswagen provides an illustration of how misconduct, in this case initially blamed on rogue engineers, quickly escalated to the executive ranks. Within the company, it was well known that CEO Winterkorn was a perfectionist noted for paying attention to detail. As a result, analysts have questioned how a man who would berate staff over the shine on chrome parts could have been in the dark about the engineers' behavior. In the U.S. "Winterkorn was known for carrying a measuring stick to check the uniformity of parts, and he would often bring two cars of a particular model to an auto show in case he was unhappy with the looks of the one on display"[20]. These behaviors contributed to internal, intentional attributions for misconduct to CEO Winterkorn, leading individual stakeholders and directors to view him as tarnished.

The frequency of the conduct or performance underlying the violation may also influence whether the CEO is perceived as tarnished. Ceteris paribus, if stakeholders and directors judge that the violation is an isolated event, the CEO is less likely to be tarnished. This factor was significant in the attribution of poor performance and misconduct when a single trader, Bruno Iksil, nicknamed the *London Whale,* made aggressive trading bets that resulted in a trading loss of $6.2 billion for JP Morgan. While the SEC investigation revealed that JP Morgan Chase & Co. failed to keep watch over its

traders, the ramifications of the scandal (although very large) were limited to the London office and it was considered an isolated event. In contrast, when Siemens was found guilty of paying $1.4 billion in bribes to secure contracts in Asia, Africa, Europe, the Middle East, and South America, the CEO was held accountable. In this case, the German and US government agencies investigating the company noted that "for much of its operations across the globe, bribery was nothing less than standard operating procedure for Siemens"[21]. Thus, Siemen's misconduct was perceived as intentional and not only reoccurring, but an integral part of the company's strategy to procure business. So, it was not surprising that Siemen's CEO, along with more than 80% of the senior management team, were considered tarnished in the scandal. Finally, even when the corporate misconduct or poor performance is viewed as unintentional and/or an isolated event, if the negative ramifications of misconduct are significant for the firm, the CEO is still likely to be tarnished. For example, Hewlett Packard CEO Apotheker was held responsible for the disastrous $11.1 billion acquisition of Autonomy in 2011, in which the lack of due diligence resulted in an $8.8 billion write-off. While the damage to HP was unintentional, he was fired after just 11 months in office due to the considerable destruction in the firm's market value. See Table 1 for examples of how violations of expectations may be attributed either internally or externally by stakeholders.

Table 1 about here

Factors that Influence Perception & Attribution

Perceiving violations and making attributions for them are socio-cognitive processes that are also, however, susceptible to systematic influence due to contextual

factors and cognitive biases (see Table 2).

Table 2 about here

Contextual Factors

Many different contextual factors may influence individual stakeholder and director perceptions and attributions of violations, such as corporate culture, national culture, or critical events in the firm's history. For the purposes of illustration, we focus on the impact of media attention and economic/market conditions. First, the media has been shown to influence individual stakeholder perceptions and attributions by "disseminat[ing] information, fram[ing] issues, and assist[ing] stakeholders in making sense of firm actions".[22] Second, CEOs often attribute poor performance to negative economic/market conditions. "These self-serving attributions appeared to be convincing to the investing public, since the use of these attributions was associated with subsequent improvements in stock price."[23]

Media Attention. As more and more sources for news on companies and CEO conduct emerge (e.g. Instagram, Twitter), the media has become increasingly important and influential in stakeholder evaluations of CEOs. Media attention increases scrutiny of a company's performance or conduct, frames it in a positive or negative light, and amplifies or downplays its importance. If corporate conduct or performance is framed as negative and significant, it is more likely to be perceived as a violation of individual stakeholders' and directors' expectations. In contrast, if the media downplays the importance of the conduct or performance, or frames it in a more positive way, it is less likely that individual stakeholders and directors will perceive it as a violation.

The media's coverage of stock option backdating illustrates how it can influence the perception of corporate misconduct. Backdating was a widespread practice and not perceived as violating individual stakeholder and director expectations. However, after the *Wall Street Journal* ran a cover story on six egregious cases that resulted in large financial payoffs for the companies' CEOs, the practice was framed as intentionally benefitting management at shareholders expense and was cast in a negative light. As a result, negative media attention led stakeholders to perceive that companies which backdated stock options violated their moral and economic expectations.

In addition, by drawing attention and shaping the narrative surrounding misconduct, the media can influence causal attribution for violations of expectations. For example, media stories can frame firm misconduct by using "'bad apples' language that shift[s] blame from the corporations onto individuals"[24]. If this occurs, there is a greater likelihood that stakeholders will blame the CEO for company misconduct or poor performance. In the case of stock option backdating, the *Wall Street Journal's* cover story identified the individuals who benefitted from this practice, as well as the valuation of their backdated stock options. As a result, the press framed the companies' CEOs as culprits in the practice, prompting a record number of complaints to the SEC.

In contrast, media narratives can be framed to showcase that external conditions led to the company's misconduct or poor performance. In the case of the Bangladesh garment factory fire, the media brought global attention to unsafe working conditions and low wages in Bangladesh, rather than placing blame on the Western retailers, who utilized these factories. News stories consistently focused on the persistent problem in Bangladesh's garment industry, while citing that retailers such as H&M and Wal-Mart

had poor controls over their supply chain, even often implicating a “rogue employee” for authorizing the order. Thus, the media’s influence contributed to individual stakeholders and directors blaming factory owners and managers rather than the CEOs of the European and US apparel companies.

Economic and Market Conditions. Economic and market conditions also shape perceptions and attributions of expectation violations. For example, poor economic conditions influence stakeholders’ economic expectations regarding firm performance. In an adverse or poor economic environment, stakeholders may have greater tolerance for performance that misses earnings expectations. For example, poor financial performance in 2001 was expected for many companies following 9/11, so CEOs were less likely to have perceptions of violation attributed to them.

Cognitive Biases

Perceptions and attribution can also be unconsciously influenced by cognitive biases. Although there are many potential sources of bias, we choose to focus on the “halo effect” or celebrity, ingroup versus outgroup dynamics, and cognitive dissonance and self-justification, as these specific biases are most likely to have an impact on how stakeholders and directors evaluate the CEO’s conduct or firm performance.

Halo Effect and Celebrity. Both the halo effect[25] and CEO celebrity[26] may have an impact on whether a CEO is considered tarnished. Under these cognitive biases, stakeholders are more likely to perceive ambiguous information about the CEO in a positive light and to attribute poor firm performance or misconduct to external sources. This systematic bias accounts for why some CEOs are not held accountable despite repeated poor performance or misconduct, while other CEOs who lack the halo effect or

celebrity status are perceived as tarnished under these conditions.

The halo effect occurs when the positive assessment of a person in one area leads to an overall positive view of that person's character, whether it is warranted or not. According to expectancy violation theory, when a CEO exceeds expectations in one area, stakeholders experience a high-intensity positive emotional reaction. This positive emotional state shapes future perceptions of the CEO's behavior in other areas in a favorable manner, creating a halo effect.

Similarly, a CEO may be considered a celebrity. This perception occurs when journalists attribute a company's positive performance to its CEO's actions.[27] Again, this designation positively influences individual stakeholder and director perceptions and attributions of future CEO behavior.

General Electric's CEO Jeff Immelt exemplifies how the halo effect and celebrity can insulate a CEO from being tarnished. Forbes ranked Jeff Immelt of General Electric as the 4th worst performing CEO in 2012. Since his appointment in 2001, GE's financial performance provided investors with a -33% return versus a 92% return for the S&P 500 (as of 8/17/2015). However, despite GE's stock languishing at half of its value since his appointment in 2001 and the fact that he consistently missed earnings targets, "no major shareholder has attacked Immelt publicly and no proxy advisory firm has told clients to vote against him as a director"[28].

Immelt's stellar performance at GE's medical systems, a business that more than doubled in size in six years to become the market leader in the industry, led to his appointment as GE's CEO. His halo from his track record at GE's highest performing business influenced individual stakeholders and directors to blame Jack Welch for GE's

poor performance, as he had heavily invested in real estate, financial services, subprime mortgages, and insurance, which were all hit hard by 9/11 and the 2008 financial meltdown.

In addition, Immelt's celebrity arose because the company is consistently among Fortune's most admired companies (ranked #9 in 2015). He benefitted from the stellar reputation that the company and its management has in the business press, as evidenced by his appointment as President Obama's top outside economic advisor in 2011 (which further reinforced his celebrity status). As a result, due to his halo and celebrity status, Immelt has been held less accountable for the company's lackluster performance during his tenure than other CEOs with similar firm performance during this time period.

Ingroup vs. Outgroup Dynamics. Individual stakeholder and director perceptions and attributions of violations are directly influenced by whether they perceive the CEO to be a member of their ingroup. However, there are many different dimensions on which this evaluation can occur; and the evaluation is entirely dependent on which dimension of groupness is in the attentional spotlight. For example, employees and directors are more likely to consider an insider CEO (promoted from within) an ingroup member, as opposed to an externally appointed CEO. Similarly, industry experience may influence whether employees or customers view the CEO as an ingroup or outgroup member. For example, Louis Gerstner, the former CEO of RJR Nabisco, was appointed CEO of IBM and was considered an outgroup member by the firm's employees, buyers, suppliers and directors due to his lack of experience in the computer industry.

Understanding whether a CEO is an ingroup or outgroup member is important because individual stakeholders and directors tend to rate ingroup CEOs more favorably

than outgroup CEOs.[29] Thus, whether stakeholders perceive the CEO as a member of their "group" can systematically influence perception of violations and attribution of misconduct or poor performance.

There is one exception to this tendency. When a perceived ingroup CEO's behavior obviously violates "norms exclusive to their respective ingroup"[30] he is judged more harshly than when a perceived out-group CEO acts in the same manner. This process is known as the black sheep effect,[31] and occurs because behavior violating ingroup expectations threatens organizational identity and existence. This exception occurred with Dov Charney, the founder and CEO of American Apparel. Individual stakeholders and directors perceived American Apparel as explicitly valuing workers, providing them with an ethical work environment. After CEO Charney defended his use of exploitive, sexist language in depositions for several sexual harassment lawsuits, individual stakeholders and directors perceived him as tarnished, as his continued behavior of intimidation and sexual abuse was inconsistent with the company's norms.

Cognitive Dissonance & Self-justification. Finally, cognitive dissonance[32] – discomfort arising from a conflict between previously held beliefs and new information and the self-justification that arises to minimize this discomfort – influence how individual directors and stakeholders perceive corporate conduct and attribute violations. Directors that appointed a CEO presumably think their choice represents a highly qualified and competent individual, and thus it is difficult for these same directors to confront the situation when misconduct or poor performance occurs, as holding the CEO liable contradicts the belief that they appointed a highly-qualified person. Furthermore, directors may have previously approved the CEO's strategic decisions and performance.

As a result, they display retrospective rationality, becoming even more committed to their prior courses of actions despite evidence to the contrary. For example, Microsoft's board approved the Nokia acquisition decision in 2013, which may have made it more difficult for the directors to later question the soundness of this strategic decision and to suggest that CEO Steve Ballmer should step down. Thus, cognitive dissonance and self-justification directly influence perceptions and attributions of violations.

Interactions of Contextual Factors and Cognitive Biases

Contextual factors and cognitive biases may also interact to amplify or attenuate perceptions and attributions. For example, Ron Johnson was hired as CEO of JC Penney because of the halo effect from his prior success at Apple and Target. Though appointed with great fanfare, his turnaround plan for the company proved to be disastrous, resulting in more than a 50% drop in the firm's stock price. Both the media and the financial community, while embracing him at first due to his prior track record, were quick to call for his dismissal, which occurred after only 17 months in the job. Thus, increasingly negative media attention quickly removed his halo.

In summary, perceptions and attributions of violations of stakeholders' expectations are socio-cognitive processes that are influenced by contextual factors (e.g. media attention and economic/market conditions) and cognitive biases (e.g. halo effect or celebrity, ingroup vs. outgroup dynamics, cognitive dissonance and self-justification), as well as interactions between these two factors. Thus, it becomes imperative for board directors to determine which contextual factors and cognitive biases are influencing stakeholder perceptions and attributions of violations to determine the validity of these judgments. It is important to note that this portion of the model is iterative, as individual

stakeholder or director perceptions of whether the CEO is tarnished may change as new information is received or the context of the situation changes.

BOARD'S EVALUATION

Even if individual stakeholders perceive the CEO to be tarnished, the board may still not respond. For a CEO to be at risk of losing his job, the board must decide that the tarnished CEO needs to be dismissed. In this process, the board needs to determine which stakeholders to attend to and which it can ignore, as it is unlikely that all stakeholders will simultaneously view the CEO as tarnished. In the following, we argue that attributes of both the claim and the stakeholder, and individual directors' motivation and cognitive biases, may influence the board's decision. Finally, the individual directors' perceptions of the CEO play a role in this decision.

Stakeholder Judgments and Their Influence

Once one or more stakeholder perceives that the CEO is tarnished, the company's board of directors must weigh this information and decide whether to acknowledge and respond to the claim(s). The board must take into consideration that not all the firm's stakeholders will agree with this view of the CEO. For example, the firm has a variety of investors with different expectations of firm performance. An activist hedge fund may consider the firm's performance so problematic that it considers the CEO tarnished, while the firm's institutional investors may not agree with this assessment. Thus, the board must determine whether to dismiss the CEO given that not all of the firm's investors share the view held by the activist hedge fund. Utilizing stakeholder theory, we propose that the process by which the board weighs these different views is influenced both by characteristics of the stakeholders and their claims, specifically: 1) stakeholder power, 2)

stakeholder and claim legitimacy, and 3) claim urgency.

A stakeholder's power is dependent on the extent to which it "has or can gain access to coercive, utilitarian, or normative means, to impose its will in the relationship"[33]. Thus, when a powerful stakeholder perceives a CEO to be tarnished, it has greater influence on the board's decision. While some stakeholders (e.g. a major shareholder) may hold a lot of power, others may not have the same level of influence. However, when multiple low-powered stakeholders collectively judge the CEO as tarnished, their ability to influence the board increases.

A stakeholder also gains influence from legitimacy. Legitimacy is "a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some social constructed system of norms, values, beliefs and definitions"[34]. Stakeholders with greater legitimacy have more influence on the board. For example, governmental agencies or regulatory bodies (like the SEC, whose primary responsibility is to enforce securities law) are likely to influence the board.

Finally, the board is influenced by claims that are urgent in nature. The concept of urgency captures two characteristics of stakeholders' claims. First, urgency reflects the "time-sensitive nature" of the claim. Second, it encompasses the criticality or importance of the claim to the stakeholder. As a result, a claim with greater urgency will have more influence on the board's decision to dismiss the CEO. For example, Interpublic Group fired Jim Palmer, CEO of Campbell Ewald because CEO Palmer did not terminate a director who had written a racist memo that had circulated internally. The current racial tensions in the US rendered the violation particularly sensitive, creating a sense of urgency for Interpublic's board to act.

Although a stakeholder or claim with greater power, legitimacy and/or urgency has “higher salience among relevant decision makers” and is therefore more likely to influence the board, this salience may still not be sufficient to determine if a particular stakeholder’s influence with key decision-makers will dominate others. Instead, decision makers’ motivations also influence how they prioritize stakeholder views of the CEO. Thus, in the case of CEO dismissal, individual directors’ motivations must be examined.

Directors’ Motivations

Individual directors’ motivation is also key to understanding whether stakeholders are likely to influence decisions. Specifically, they may be morally motivated (seeks consistency with an internal system of values); relationally motivated (seeks to build or maintain relationships with the stakeholder) or instrumentally motivated (seeks rewards or avoidance of punishment). In addition, the way the stakeholder claim is framed may situationally-induce a director’s motivation. Furthermore, these different motivations lead to differential impacts of stakeholder power and legitimacy, and claim urgency and legitimacy.

For example, a CEO that is tarnished due to violating moral expectations is likely to activate this type of motivation in firm directors. Whereas, a CEO that is tarnished due to violating organizational expectations, rooted in identity, is likely to activate directors’ relational motivations. Finally, a CEO that is tarnished due to violating economic expectations is likely to activate directors’ instrumental motivations because as board directors they will seek to avoid economic sanctions against the company. Activating these particular motivations will focus the individual director’s attention on different aspects of stakeholder and claim characteristics. For example, when determining whether

to dismiss a CEO due to corporate misconduct, government agencies with legal authority are likely to get more attention from directors with a moral motivation than other stakeholders.

Directors' Judgments and Cognitive Biases

In the final determination of whether to dismiss a tarnished CEO, the board is also influenced by individual director judgments of the CEO. As indicated in Figure 2, individual directors develop their own perceptions of whether the CEO is tarnished. As in the earlier example involving Chris Viehbacher of the French pharmaceutical company Sanofi, individual directors perceived that the CEO was tarnished, even though other stakeholders did not. The board was unanimous in its decision, and dismissed the CEO despite this fact. Thus, at times, the board prioritizes its view of the CEO over those of individual stakeholders.

In making decisions about whether to dismiss the firm's CEO, individual directors are subject to unconscious biases. Each director has a different background and experiences that influence his sensitivity to certain stakeholders' expectations. For example, a director with experience in consumer goods industries is more likely to pay attention to violations of customer expectations. Similarly, a director with a financial background is more likely to be sensitive to violations of investors' expectations. If the particular claim of violation is too far outside of an individual director's prior experience, however, he is less likely to relate to it and thus respond.

An individual director's prior board and CEO experience is also likely to influence his perceptions of stakeholders and claims. Directors that have dealt with a particular type of stakeholder violation in the past are likely to draw on that experience

and have different perceptions than those without such experience. For example, a director's experience with a particular type of investor (e.g. activist hedge fund) is likely to influence how he may respond when encountering this same investor at another firm.

Whether the board will respond to a stakeholder's violation is also influenced by the degree to which directors are independent in their assessment of the CEO. Although the conscious influence of director independence has been previously studied, there are additional unconscious influences that arise. For example, directors that are CEOs at other firms may tend to be more empathetic and thus less critical of the CEO on whose board they serve. Furthermore, as directors develop a closer working relationship with the CEO and/or social ties, they are more likely to unconsciously interpret CEO behavior in a more positive light.

INSIGHTS FOR BOARD DIRECTORS FROM OUR MODEL

Our model highlights two processes, how a CEO becomes tarnished and how the board evaluates the tarnished CEO. Knowledge about these two processes better equips the board to address instances of corporate misconduct and/or poor performance. In this section, we outline specific recommendations that arise from our model, which allow the board to make more informed, and less reactive, decisions to either avert or address stakeholder claims that the CEO is tarnished.

First, the board must familiarize itself with individual stakeholders' expectations. To accomplish this task, board directors should map out the firm's potential stakeholders and their expectations in a matrix, focusing on individual stakeholders with high power or visibility, such as their main institutional investors or activist hedge funds that have a financial stake in the firm. They should then list various economic, moral and

organizational expectations that these powerful stakeholders have about firm behavior. Then, the directors should articulate their own individual expectations about firm performance, so that the entire board is aware of each individual director's expectations. Once these expectations are mapped out, the board should carefully examine them to get a sense of the threshold beyond which firm performance or misconduct will trigger a violation for influential stakeholders. Thus, the board can develop a roadmap of the type and level of firm behavior and performance likely to trigger violations, which should be continually updated as stakeholder expectations change.

Second, our framework highlights that boards need to be much more sensitive to the role of contextual conditions and stakeholders' cognitive bias that influence how corporate misconduct and/or poor performance are evaluated. In today's media world, a video released through social media can instantly lead to widespread condemnation of the firm and its management (e.g. the recent video of a passenger being dragged off an overbooked United Airlines flight). In fact, a crisis involving social media is often viewed as a threat to company profits and is increasingly monitored by all employees, not just those in marketing and PR (e.g. one of Carl's Jr. CEO's first acts was to install monitors displaying real-time social media comments throughout the company)[35]. Like other performance metrics that are monitored by the board on a regular basis, the firm's media-driven reputation needs to be frequently reported to the board. If boards become accustomed to regular dashboard readings of the firm's and CEO's reputation, they will be better prepared to understand whether and how poor performance and/or corporate misconduct will have an impact on the firm.

Third, the board can influence CEO and firm conduct through oversight. For example, management traditionally audits working conditions in off-shore factories. But the board can take a more proactive role by visiting these sites and suggesting changes to management to prevent stakeholder perceptions of violation in the first place. Moreover, the board may benefit from random “field trips” without management to get an unfiltered view of the organizational culture. Subsequent sharing of this anecdotal information can enrich the board’s more formal feedback channels and help it spot problems before they occur.

Fourth, to make their own evaluation of a tarnished CEO more objective, the board may want to conduct routine formal discussions facilitated by an independent board member or a consultant, analyzing real misconduct or poor performance at other firms as case studies. This “Board in the Spotlight” exercise entails an in-depth discussion about the sequence of events that occurred - e.g. type of misconduct, stakeholders’ expectations and violation thresholds, attributions, and the eventual outcome. These exercises should get all board directors including the CEO involved to discuss the facts of the situation, their interpretations of stakeholders’ expectations, how firm behavior was perceived to violate these expectations, and what led to attributions whereby the CEO became tarnished. Such neutral deliberations help the board step back and become more aware of stakeholders’ perceptions and provide greater insight into the socio-cognitive processes underlying stakeholder perceptions that the CEO is tarnished.

Such exercises can also help reveal differences of opinion among directors and insights into how to manage them. Open discussion of another firm’s situation can remove the inherent tension of differing views because, “after all, it is their problem, not

ours”. In addition, by actively comparing misconduct in its firm with a similar situation in another firm, the board may be able to recognize when its own directors lack independence, which may lead to a defense of the CEO, even in light of ample evidence that he is tarnished. Once this bias is recognized, the board should call on a pool of highly visible, independent, respected individuals to investigate the incident of misconduct and provide an objective recommendation. For example, the board of Uber appointed former US Attorney General Eric Holder to investigate claims of a culture allowing sexual harassment.

Additionally, although diverse perspectives on the board are beneficial, they can lead to schisms between directors. Thus, despite its best efforts, boards can still be stuck at a crossroads without a consensus on the appropriate course of action, resulting in a wait and see attitude. To avoid this issue, we suggest the board conduct a more thorough review of whether this type of firm misconduct is likely to lead stakeholders to view the CEO as tarnished. If influential stakeholders or a large group of less influential stakeholders are going to perceive the CEO as tarnished, a tipping point occurs where directors can no longer avoid stakeholders’ concerns and need to confront the CEO’s and their own shortcomings. This process allows the board to recognize this tipping point proactively, rather than after it has already occurred. For example, this evaluation would have clearly identified the CEO’s behavior in the VW emissions scandal as misconduct that should not have been ignored by the board.

The recent scandal at Wells Fargo & Company illustrates how these recommendations could have resulted in a better firm outcome. Since 2011, Wells Fargo corporate policy of absolute growth (with the subtle underlying message that anything

goes) drove an abusive practice that resulted in the illegal creation of more than 2 million accounts without customer authorization. If the board had mapped out stakeholder expectations, it would have realized that this practice violated moral expectations for several different stakeholders and could have corrected it through monitoring. This practice was first reported by the LA Times in 2013, which brought negative media attention to it and further signaled to the board that it should be addressed. However, only after a lawsuit was filed in May of 2015 did the board set up an independent committee to investigate the allegations. Again, if the board had considered the influence of the media on stakeholder perceptions of violations, it could have anticipated the firestorm that erupted from this coverage. On September 8, 2016, Wells Fargo agreed to pay a $187.6 million fine and admitted to “widespread illegal” behavior. Despite the severity of the scandal and the considerable damage to Wells Fargo’s reputation, the board remained loyal to the CEO. This loyalty in the face of financial penalties and legal rulings against the firm suggests that the board had significant biases in weighing stakeholder views of the CEO, particularly stemming from lack of board independence and advanced director tenure (average of 9.5 years). However, congressional hearings on September 29, 2016 resulted in renewed attention to the scandal when CEO John Stumpf was questioned by members of Congress who compared him to an actual bank robber and accused him of running a “criminal enterprise”. At this point, the board’s moral motivation was activated, and it could no longer ignore stakeholder claims that the CEO was tarnished, and was forced to dismiss him. Thus, the congressional hearings were the tipping point when the board finally concluded that the CEO must be dismissed. In this case, a visible and important stakeholder (e.g. Congress) along with negative media attention meant that the

board was required to recalibrate its evaluation and response to the scandal by dismissing the CEO. Our framework provides insight into why the board did not act earlier, and our recommendations demonstrate how the board may have minimized this scandal by anticipating stakeholder violations and attributions, and the influence of contextual factors and cognitive biases on these processes.

CONCLUSION

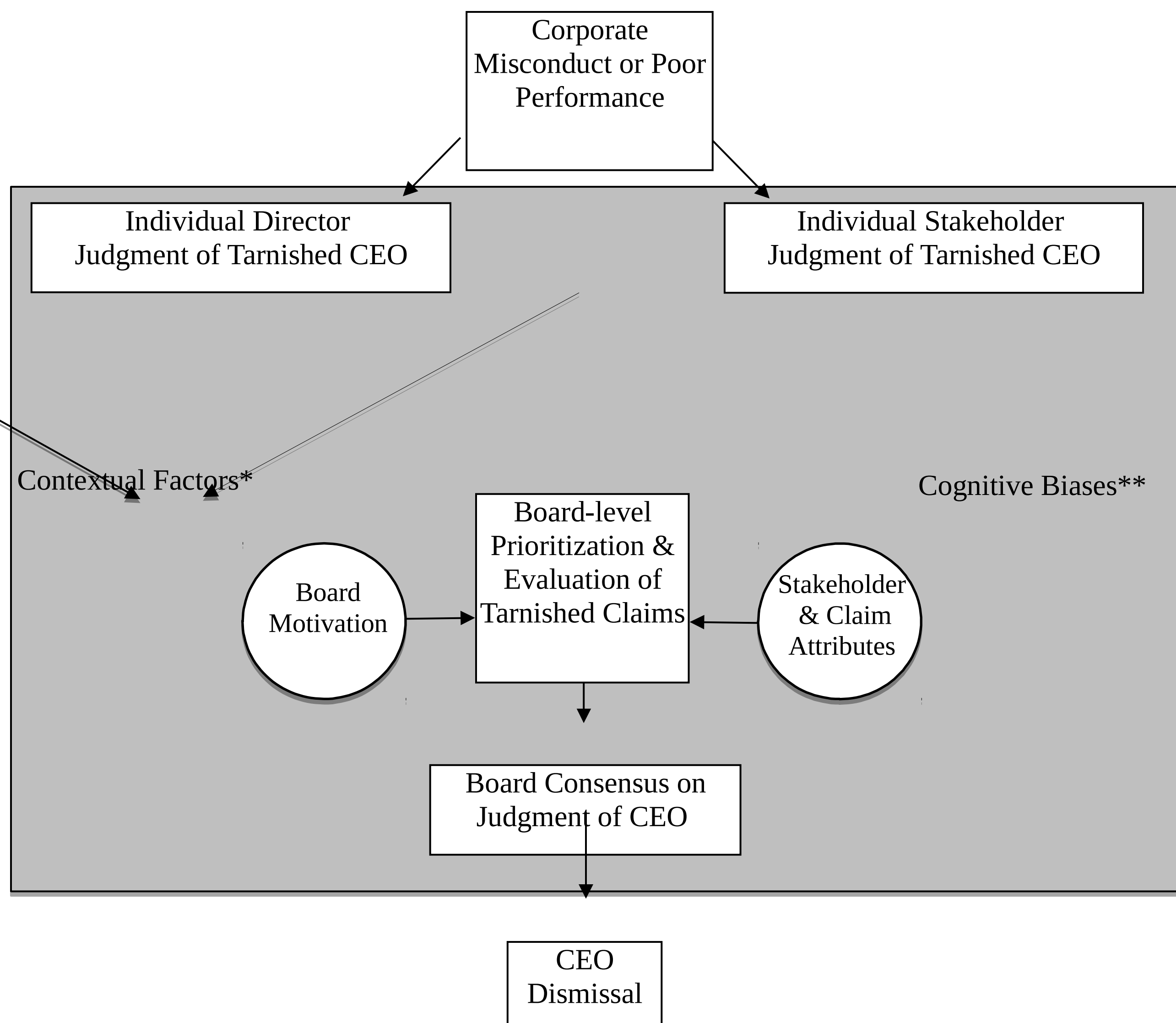
Being a director is a multi-faceted responsibility with clear fiduciary, moral and organizational obligations. Most significantly, the board alone holds the responsibility for determining if a CEO should be dismissed in the wake of poor performance or corporate misconduct. Prior research has treated this decision as a rational one that is not subject to stakeholder perceptions of expectation violations, contextual influences, stakeholder or claim characteristics, director motivations or cognitive biases. However, by modeling the socio-cognitive processes that shape stakeholders' views of the CEO following misconduct or poor performance, as well as the board's interpretation and response to stakeholders' judgments that the company's CEO is tarnished, we expand our understanding of why some boards dismiss their CEOs while others do not and shed light on what are sometimes puzzling outcomes.

We are also able to provide specific advice to boards to enable them to act proactively, rather than reactively, and to remove bias from their decisions as to whether to dismiss a tarnished CEO. First, we suggest that the board should map out stakeholders' expectations and potential thresholds of violation, including contextual and cognitive factors that act as shift factors. Second, we urge the board to use this understanding of stakeholder violation thresholds to anticipate when corporate conduct and firm

performance will lead to the perception of the CEO as tarnished. If the board feels that the CEO is being unfairly tarnished, it should attempt actively to manage the stakeholder's attribution process by identifying when interventions to shape media coverage or CEO reputation may be most effective. Third, the board should remove bias from its own dismissal decision by using "Spotlight on the Board" case studies to evaluate similar situations in the context of a different firm. Finally, it should determine the appropriate tipping point for CEO dismissal by evaluating how different stakeholder claims that a CEO is tarnished will have an impact on the firm. Together, these recommendations allow the board to anticipate stakeholder perceptions that the CEO is tarnished, have a plan in place to address or ignore these claims, and remove their own cognitive biases in these decision processes, resulting in more effective CEO dismissal decisions for the firm and its stakeholders.

FIGURES & TABLES

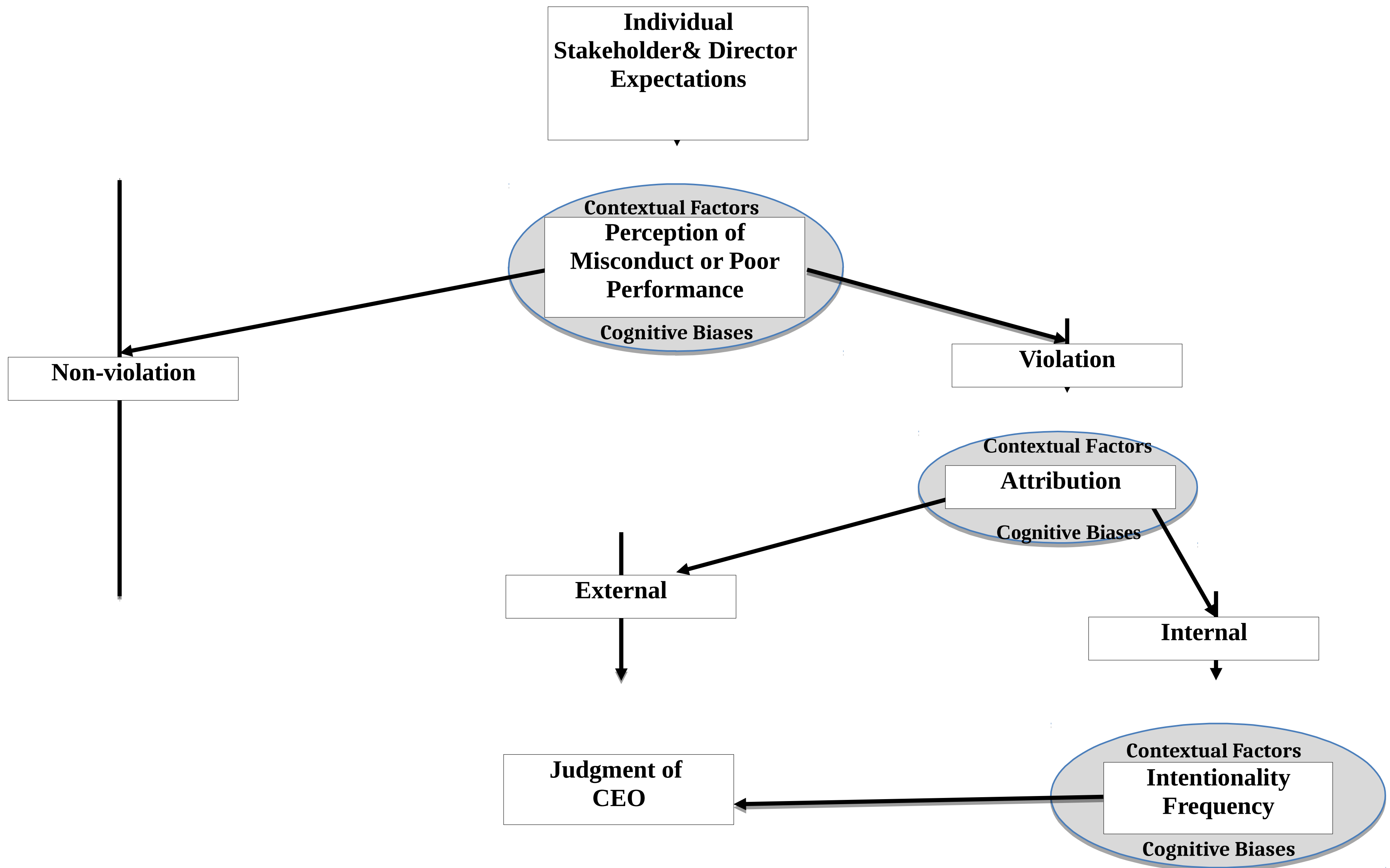
Figure 1. Model of CEO Dismissal



*****Contextual factors in this model include but are not limited to media attention, economic/market conditions, corporate culture, national culture, and the firm's history of critical events. Media attention and economic/market conditions are offered as examples in later sections of the paper.

**Cognitive biases include but are not limited to the "halo effect" or celebrity, ingroup versus outgroup dynamics, and cognitive dissonance and self-justification, which are all discussed in later sections of the paper.

Figure 2. Socio-Cognitive Model of CEO Evaluation by Individual Stakeholders & Directors



Event	Stakeholders' Perceptions	Stakeholders' Attribution	Stakeholders' Evaluation of CEO
Poor Financial Performance	Violation of Economic Expectations	External	**Not tarnished:** ExxonMobil, Shell, ConocoPhillips, BP, Total not held accountable due to the drop in global oil prices (6 companies had a $200 billion drop in market capitalization in 2015 due to lower stock prices)
Poor Financial Performance	Violation of Economic Expectations	Internal-intentional	**Tarnished:** Sotheby's CEO Ruprecht held accountable for his strategy, which significantly underperformed its rival Christies as well as the Dow Jones Index, while the art market was booming
Bangladesh Garment Factory Fire	Violation of Moral Expectations	External	**Not tarnished:** H&M and other retailers not held accountable since the factory was a contractor that had been repeatedly found to have unsafe working conditions which were not addressed by the owners
Deep Water Horizon Accident	Violation of Moral Expectations	Internal-frequent	**Tarnished:** British Petroleum CEO Hayward was held accountable for a company that had a history of safety lapses

Table 1. Internal vs. External Attribution of Violations

Event	Stakeholders' Perceptions	Stakeholders' Attribution	Moderating Factors	Stakeholders' Evaluation of CEO
Poor Financial Performance	Violation of Economic Expectations	Internal-isolated /unintentional	Halo Effect	**Tarnished:** Microsoft – CEO Ballmer was held accountable for failing to position Microsoft competitively in mobile technology **Not tarnished:** General Electric – CEO Immelt was not blamed for poor financial performance due to being well regarded within society and the business community
Data Security Breach Scandal	Violation of Moral Expectations	Internal-isolated /unintentional	Media Attention	**Tarnished:** Target − CEO Steinhafel held accountable as a result of intense media attention to the largest security breach at the time (100 million customers in 2014) **Not tarnished:** Anthem − CEO Swedish not held accountable because of significantly less media attention due to the increasing incidences of security breaches (80 million patient records in 2015)
Financial Scandals	Violation of Moral & Financial Expectations	Internal-reoccurring /intentional	Halo Effect	**Tarnished:** Bank of America − CEO Lewis blamed for lying to shareholders about Merrill Lynch's $16 billion loss prior to merger vote by shareholders **Not tarnished:** JP Morgan − CEO Dimon not held accountable despite numerous scandals and fines of over $12 billion due to the halo effect arising from his stellar financial performance
Backdating of Stock Options	Violation of Moral & Financial Expectations	Internal-reoccurring /intentional	Media Attention	**Tarnished:** United Health − CEO McGuire held accountable as a result of being highlighted in the WSJ article that brought attention to the scandal **Not tarnished:** Multiple companies also guilty of backdating but implicated later in the scandal after media attention died down

Table 2. Differential CEO Judgements due to Influence of Contextual Factors and Cognitive Biases on Internal Attribution

1 CEO dismissal refers to the involuntary departure of the CEO, regardless of the formal announcement given by the company as to the nature of the departure (e.g. stepped down, retired). The dismissal of the CEO can be ascertained by examining whether the CEO departure was abrupt, with no replacement CEO identified, as well as by examining news items surrounding the circumstances of the CEO's departure (Wiersema & Zhang, 2011).

2 Conference Board, 2014

3 I.F. Kesner, and T.C. Sebora, "Executive Succession: Past, Present & Future," Journal of Management, 20/2 (1994): 327-372; K.J. Murphy, and J.L. Zimmerman, "Financial Performance Surrounding CEO Turnover," Journal of Accounting and Economics, 16/1 (1993): 273-315.

4 M. L. Arthaud-Day, S.T. Certo, C.M. Dalton, and D.R. Dalton, "A Changing of the Guard: Executive and Director Turnover Following Corporate Financial Restatements," Academy of Management Journal, 49/6 (2006): 1119-1136; H. Desai, C.E. Hogan, and M.S. Wilkins, "The Reputational Penalty for Aggressive Accounting: Earnings Restatements and Management Turnover," The Accounting Review, 81/1 (2006): 83-112; M.F. Wiersema, and Y.A. Zhang, "Executive Turnover in the Stock Option Backdating Wave: The Impact of Social Context," Strategic Management Journal, 34/5 (2013): 590-609.

5 E.B. Fama and M.C. Jensen, "Organizational Forms and Investment Decisions," Journal of Financial Economics, 14/1(1985):101-119.

6 A socio-cognitive perspective refers to combining social and cognitive psychological lenses to examine decision-making. In this paper, we use theories from cognitive psychology (e.g. cognitive biases) and social psychology (e.g. attribution and expectancy violation theory) to examine how the board's decision to dismiss a CEO is influenced by these unconscious processes.

7 B.A. Bettencourt, K.E. Dill, S.A. Greathouse, K. Charlton, and A. Mulholland, "Evaluations of Ingroup and Outgroup Members: The Role of Category-Based Expectancy Violation," Journal of Experimental Social Psychology, 33 (1997): 244-275; J. Burgoon, "Interpersonal Expectations, Expectancy Violations, and Emotional Communication," Journal of Language and Social Psychology, 12 (1993): 30-48;
L. Jussim, L.M. Coleman, and L. Lerch, "The Nature of Stereotypes: A Comparison and Integration of Three Theories," Journal of Personality and Social Psychology, 52 (1987): 536-546.

8 B. Weiner, "An Attributional Theory of Achievement Motivation and Emotion," Psychological Review, 9/4 (1985): 548-573.

9 J.W. Fredrickson, D.C. Hambrick, and S. Baumrin, "A Model of CEO Dismissal," Academy of Management Review, 13/2 (1988), 255-270.

10 J.G. March, and J.P. Olsen, "The Logic of Appropriateness", in M. Moran, M. Rein and R.E. Goodin eds., The Oxford Handbook of Public Policy, (Oxford: Oxford University Press, 2006, p. 3).

11 Although environmental expectations are also commonly studied in management literature in the context of corporate social responsibility, these expectations are considered a subset of moral expectations that stakeholders have for the firm (e.g. Carroll, 1991).

12 E. Durkheim, Moral Education: A Study in the Theory and Application of the Sociology of Education, translated by E. K. Wilson and H. Schnurer (New York: The Free Press, 1961).

13 D. Jolly and A. Pollack, "Sanofi Fires Its Chief Executive but Retains His Global Strategy," New York Times, (October 29, 2014), https://www.nytimes.com/2014/10/30/business/international/christopher-viehbacher-sanofi-chief-ousted-by-board.html?_r=0

14 B.A. Le Poire, and J.K. Burgoon, "Usefulness of Differentiating Arousal Responses Within Communication Theories: Orienting Response or Defensive Arousal Within Nonverbal Theories of Expectancy Violation," Communication Monographs, 63/3 (1996): 208-230.

15 J.P. Forgas, "Mood and Judgment: The Affect Infusion Model (AIM)," Psychological Bulletin, 117/1 (1995): 39-61; J.P. Forgas, and G.H. Bower, "Mood Effects on Person Perception Judgments," Journal of Personality and Social Psychology, 53 (1987): 53-60.

16 F. Heider, The Psychology of Interpersonal Relations. (New York: Wiley, 1958).

17 S.T. Fiske and S.E. Taylor, Social Cognition, 2nd Edition (New York: McGraw-Hill, 1991).

18 E. McAuley, T.E Duncan, and D.W. Russell, "Measuring Causal Attributions: The Revised Causal Dimension Scale (CDSII)," Personality and Social Psychology Bulletin, 18/5 (1992): 566-573.

19 B. Weiner, J. Amirkhan, V.S. Folkes, and J.A. Verette, "An Attributional Analysis of Excuse Giving: Studies of a Naive Theory of Emotion," Journal of Personality and Social Psychology, 52/2 (1987): 316-324.

20 Autonews, "Volkswagen CEO Winterkorn Resigns Amid Diesel Emissions Scandal," (September 23 2015) http://www.autonews.com/article/20150923/OEM02/150929922/volkswagen-ceo-winterkorn-resigns-amid-diesel-emissions-scandal

21 U.S. Department of Justice. "Siemens AG and Three Subsidiaries Plead Guilty to Foreign Corrupt Practices Act Violations and Agree to Pay $450 Million in Combined Criminal Fines," (2008) http://www.justice.gov/archive/opa/pr/2008/December/08-crm-1105.html

22 Quote from p. 1079 of A. Zavyalova, M.D. Pfarrer, R.K. Reger, and D.L. Shapiro, "Managing the Message: The Effects of Firm Actions and Industry Spillovers on Media Coverage Following Wrongdoing," Academy of Management Journal, 55/5(2012), 1079-1101

23 Quote from p. 582 of B.M. Staw, P.I. McKechnie, and S.M. Puffer, "The Justification of Organizational Performance," Administrative Science Quarterly 28/4 (1983): 582-600.

24 G. Cavender, K. Gray, and K.W. Miller, "Enron's Perp Walk: Status Degradation Ceremonies as Narrative," Crime, Media, Culture, 6/3 (2010): 251-266.

25 E.L. Thorndike, "Intelligence and its Uses," Harper's Magazine, 140 (1920): 227-235.

26 H.H. Kelley, and J.L. Michela, "Attribution Theory and Research," Annual Review of Psychology, 31/1(1980): 457-501.

27 M.L. Hayward, V.P. Rindova, and T.G. Pollock, "Believing One's Own Press: The Causes and Consequences of CEO Celebrity," Strategic Management Journal, 25/7 (2004) 637-653.

28 Fortune, "Grading Jeff Immelt," Fortune Magazine, (February 10, 2011) http://fortune.com/2011/02/10/grading-jeff-immelt/

29 D.M. Messick, and D.M. Mackie, "Intergroup Relations," Annual Review of Psychology, 40 1989 (1989): 45-81.

30 Bettencourt et al., op. cit., p. 247

31 J.M. Marques, V.Y. Yzerbyt, and J.P. Leyens, "The "Black Sheep Effect": Extremity of Judgments Towards Ingroup Members as a Function of Group Identification," European Journal of Social Psychology, 18/1 (1988): 1-16.

32 L. Festinger, A Theory of Cognitive Dissonance. (Evanston, IL: Row Peterson, 1957).

33 Ibid, p. 865.

34 Quote from M.C. Suchman, "Managing Legitimacy: Strategic and Institutional Approaches," Academy of Management Review, 20/3: 571-610,p. 574.

35S. Maheshwari, "United and Pepsi Affairs Force Brands to Respect Social Media," (April 13, 2017) https://www.nytimes.com/2017/04/13/business/media/united-and-pepsi-affairs-force-brands-to-respect-social-media.html?mwrsm=amp-email&_r=0