THE REPUTATION COSTS OF EXECUTIVE MISCONDUCT ACCUSATIONS

YASSIN DENIS BOUZZINE
Leuphana University Lüneburg
Institute of Management, Accounting and Finance
Universitätsallee 1
21335 Lüneburg, Germany

RAINER LUEG
Leuphana University Lüneburg
University of Southern Denmark

ABSTRACT

We examine how sexual harassment accusations against individual executives affect the stock returns of the affiliated organization. Taking an upper echelons and abuse of power perspective, we identify 372 high-profile sexual harassment accusations, of which 98 are relevant to this study. We employ event study methodology to detect abnormal stock reactions for the affiliated organization. As predicted, the results indicate that #MeToo accusations substantially harmed the stock returns of the organization despite the accusation relating to the misconduct of only a single executive. Surprisingly, we discover significant results only for executives at the parent organization.

INTRODUCTION

Incidents of misconduct are assumed to have negative implications for the organization (Greve, Palmer, & Pozner, 2010). However, we conjecture that neither the effect itself nor the extent of the effect have been fully demonstrated. Investors may react to misconduct by divesting and thus reducing the stock price (Flammer, 2013).

Capital markets’ reactions to organizational misconduct are receiving increasing academic attention. Relevant research works have investigated unethical events in terms of the potential abnormal negative returns for organizations (i.e., event studies). There is a wide discrepancy in research interest between ecological and governance issues and social issues. The research tends to focus on ecological (Bosch, Eckard, & Lee, 1998; Dasgupta, Hong, Laplante, & Mamingi, 2006; Dasgupta, Laplante, & Mamingi, 2001; Flammer, 2013; Gupta & Goldar, 2005; Hamilton, 1995; Khanna, Quimio, & Bojilova, 1998; Klassen & McLaughlin, 1996; Lanoie, Laplante, & Roy, 1998; Lundgren & Olsson, 2010; Xu, Zeng, & Tam, 2012) and governance issues (Beatty, Liao, & Yu, 2013; Jonsson, Greve, & Fujiwara-Greve, 2009; Yu, Zhang, & Zheng, 2015), whereas evidence on social misconduct (Frooman, 1997; Gunthorpe, 1997) by organizations remains scarce. Concerning misconduct by individuals, empirical evidence regarding the capital market reaction is even rarer (Song & Han, 2017).

We want to utilize #MeToo as our seminal case to shed light on the question of why investors consider individual misconduct in their investment decisions in organizations. The media provides mixed findings in that regard. MarketWatch predicted that #MeToo would not have any impact on stock performance, as it does not affect organizational profitability, and
accusations against individuals in an organization might not impact the organization as a whole. The stability of CBS’ stocks, a US-American TV network, to the accusation against Charlie Rose, a prominent TV host and journalist employed at CBS, provides anecdotal evidence of this (Vlastelica, 2017). However, TIME and CNN, US-American news networks, provide opposing evidence when retrospectively examining prominent #MeToo accusations and reporting that Guess, a famous fashion brand, and Wynn Resorts, a developer and operator of high-end hotels and casinos, both experienced substantial negative reactions due to the accusations against their executives (Cooney, 2018; Wattles & Isidore, 2018). To address this conundrum, we pose the following research question:

RQ: How do investors react to sexual harassment accusations against executives?

**METHOD**

To test our hypothesis, we apply the event study methodology proposed by MacKinlay (1997). Accordingly, we define event windows, estimate normal stock returns, calculate abnormal returns, and test for statistical significance.

Therefore, we hand-collected accusations from different media sources. Our major source is The Creep Sheet (2020), a comprehensive list of public figures accused of sexual harassment. Thereby, in line with the efficient market hypothesis, which suggests immediate market reactions to new information (Fama, Fisher, Jensen, & Roll, 1969), we select the earliest article that specifically addresses an accusation as our source and do not consider subsequent events. In total, we obtained 372 accusations from 1989 – 2019. For all of the accused persons, if not stated in the article, we investigated whether there is an organizational affiliation, whether the organization is listed on a US stock exchange, and whether it was listed when the accusation emerged. These are all preconditions for the accusations to be considered in our analysis. Then, we include only the accusations that followed the accusation against Roger Ailes (21 July 2016), as this represents the first accusation that received substantial media attention and was the beginning of a chain of sexual harassment accusations against 21st Century Fox officials. These restrictions reduced our research sample from 372 to 98 accusations.

**RESULTS**

In line with our theoretical framework, we observe a significant negative market reaction. Substantial negative CARs are reported for several executives, which provides support for rejecting H0. However, the findings are mixed; for some executives, no significant reactions can be observed at all, while for others, a substantially negative reaction is the consequence. By examining the employment characteristics of the executive, it appears that significant negative reactions are pronounced when the executive is employed at the parent organization. On the other hand, accusations against executives at parent organizations triggered substantial abnormal stock losses between -2.00% (Amit Singhal, Alphabet) and -22.63% (Paul Marciano, Guess). Thus, we conjecture that investors’ decision to sell a stock that is associated with a #MeToo scandal depends on whether the accused person holds significant managerial power over the organization, which is not given if the executive is employed at a subsidiary. In cases of employment at the parent organization, investors fear that the misconduct of the executive will spill over from the individual to the overall organization. Initial evidence of inter-organizational
misconduct spillover has already been reported for similar organizations (Jonsson et al., 2009), organizations in the same industry (Zou, Zeng, Zhang, Lin, & Shi, 2015), organizations belonging to the same conglomerate (Haack, Pfarrer, & Scherer, 2014), and organizations operating similar business models (Bouzzine & Lueg, 2020).

**DISCUSSION**

This study aimed to answer the research question, “How do investors react to sexual harassment accusations against executives?” To this end, we conducted an event study on sexual harassment accusations against executives and concluded that sexual harassment accusations are value destructive but only when they target an executive who holds significant managerial power. In other cases, it seems that the accusation is viewed by the investors as separate from the organization. This finding is in line with upper echelons theory (Hambrick, 2007; Hambrick & Mason, 1984), which attributes a special role to executives in that their values shape the overall organization due to their managerial power. Based on our findings, we conclude that investors react negatively to sexual harassment acts committed by organizational executives when they are employed at the parent organization.

Our findings offer research contributions in areas that have received little academic attention thus far. We illustrate that an individual’s misconduct can be financially relevant to the organization even if the individual’s behavior does not immediately affect profitability due to the resulting long-term reputational damage. This, in turn, provides strong evidence that reputation is an important asset to organizations that is severely threatened by executive misconduct, a fact that is ultimately manifested in financial penalties. As we detect significant reactions only for accusations against executives at parent organizations, we conjecture that sexual harassment accusations against individual executives become an organizational problem when the executive holds significant managerial power, which supports our initial Upper Echelons argument (Hambrick & Mason, 1984).

For practitioners, our finding that executives damage their organizations with sexually abusive behavior comes with important implications. First, organizations should pay particular attention when hiring executives. They should screen their histories at their prior organizations comprehensively to avoid hiring executives who have exhibited sexually abusive behavior. Second, organizations should monitor how their executives behave, and what types of work environments they create.
REFERENCES


