

DISCUSSION FORUM

Grey areas: irresponsible corporations and reputational dynamics

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At the 2013 Annual Symposium of the Oxford University Centre of Corporate Reputation, a roundtable was convened to discuss the reputational dynamics surrounding corporations engaged in ethical 'grey areas', where actions are likely to be deemed as being socially irresponsible and often later result in public scandal. The presenters wrote up their comments in the form of short essays which are collected together in this forum. The introductory piece by Jackson and Brammer challenges the conventional wisdom that irresponsible behaviour by corporations is associated with strong reputational penalties. In various ways, the Discussion Forum contributors explore why this link may be weak or highly contingent, focusing on dynamics at different levels of analysis. Karpoff identifies grey areas of firm behaviour characterized by market failures around both negative and positive externalities, and reviews evidence showing prospects and limits of reputation in this context. The next two contributions by Lange and Zavyalova address problems with the social attribution of irresponsible behaviour at a micro level of analysis. Harrington shows further how micro-level attributions are shaped by wider historical and institutional contexts by presenting evidence on how individual investors responded to the widespread fraud in wake of financial crises in the USA. Partnoy and King stress the role of public and private forms of regulation, stressing the role of macro-level institutions in defining legitimate behaviour and framing expectations about what is responsible or irresponsible. Applying these various concepts, Deephouse reconstructs the history of Apple's encounters with grey areas and the reputational consequences thereof.

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JEL classification: A13 - relation of economics to social values, L14 - transactional relationships, contracts and reputation, networks, M14 - corporate culture, social responsibility

Introducing grey areas: the unexpectedly weak link between corporate irresponsibility and reputation

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1. Endemic irresponsibility

We are all chronically aware of some major headline cases of corporate irresponsibility in the last decade or more. Corporate fraud and attempts to conceal financial losses played a prevalent role in the collapse of Enron, Worldcom or Parmalat in the early 2000s. Similarly, the current financial crisis following the collapse of the sub-prime mortgage markets both raised ethical questions about lending practices and led to the sudden collapse of major financial institutions such as Northern Rock, Bear Stearns, Lehman Brothers, AIB, ABN-Amro, the Royal Bank of Scotland and Anglo Irish Bank during 2008 and 2009. Scandals continue surrounding bribery (consider the settlement case involving Siemens in 2008), diversion of funds for prostitution (recall the case ERGO, a subsidiary of Munich RE insurance group in 2011) or irregular financial payments (such as Olympus in 2011). Perhaps even more seriously, corporations have been criticized for their role in major environmental catastrophes. British Petroleum was widely criticized following the Deepwater Horizon oil spill in 2010 or TEPCO was in the wake of the nuclear disaster in Fukushima in 2011. These issues similarly extend to labour standards, as made visible by the wave of suicides at electronics supplier Foxconn in 2010 or the deaths of 1 129 people following the 2013 collapse of a factory in Bangladesh that supplied clothing to Primark, H&M, Walmart, Gap and many other major firms.

While the most prominent cases of irresponsibility occupy column inches within the business press and resonate in popular discourse, they are only the tip of the iceberg. In fact, cases of irresponsibility are a widespread part of everyday corporate life. For example, [Clement \(2006\)](#) found that in a given 3-year period 40% of the Fortune 100 had committed acts of irresponsibility associated with a guilty plea by a firm in relation to charges of misconduct, a ruling against a firm by a government agency or a court, or an agreement by a firm to pay fines or settlements. More recently, research commissioned by Ernst and Young demonstrated that around 80% of firms experienced at least one ‘crisis event’ in a given 5-year period, with

many firms experiencing numerous such events (Ernst and Young, 2012). Long-term analysis of US companies over the 1990s and early 2000s also shows that irresponsible behaviour was more prevalent than the use of corporate social responsibility (CSR) policies, which themselves were often adopted only in response to irresponsible actions (Kotchen and Moon, 2012). Indeed, the high prevalence of corporate irresponsibility documented in this research has important, but still neglected implications for a number of different fields of scholarship—in particular, raising questions related to how stakeholders respond to irresponsible actions, and how societies seek to regulate these activities. Much of this debate hinges on the role of reputation.

The aim of this Discussion Forum is to explore the reputational dynamics surrounding negative or irresponsible behaviours of corporations. Reputation is a quintessentially sociological concept, because it is about social expectations regarding future behaviour and derives from social processes of evaluation and attribution. Reputation is also a very important concept for political economy research on governance and private regulation (Brammer *et al.*, 2012). Increasingly, as states have moved away from direct substantive regulation and enforcement, private forms of governance have proliferated. These schemes often rely on the voluntary adoption of environmental or social standards by companies.¹ The major assumption behind this approach is that by adopting socially accepted standards, corporations will acquire or maintain legitimacy vis-à-vis key stakeholders of the firm, such as their customers, investors, suppliers, employees or the communities in which they operate. Moreover, corporations may adopt better and more exclusive standards in order to improve their reputation relative to similar competing firms,² and thereby develop their reputation as an asset in terms of customer loyalty, goodwill or trust. Better understanding the processes by which corporate reputations are shaped by irresponsibility thus constitutes an important agenda for research on reputation and social evaluations, as well as for research on governance and private regulation.

2. The accepted wisdom: responsibility, irresponsibility and corporate reputations

Before going into a detailed discussion of the association between corporate irresponsibility and reputation, it is worth situating this Discussion Forum within a wider theoretical conversation. Broadly, the conventional hypothesis within the literatures on private governance, strategic management, finance and reputation management is that bad behaviour or irresponsible actions of companies will be

¹This model is widely discussed under the heading of CSR, but has an even wider application within the field of regulation.

²On the distinction between legitimacy and reputation, see Deephouse and Carter (2005).

sanctioned in terms of reputational penalties and that good behaviour will help build positive reputation (as shown in Figure 1 below). Often, scholars will cite wisdom of esteemed figures from business, politics or literature in relation to the fragility of reputation. Hence, we expect that ‘it takes 20 years to build a reputation and five minutes to ruin it. If you think about that, you’ll do things differently’ (quote attributed to Warren Buffet) and that ‘it takes many good deeds to build a good reputation, and only one bad one to lose it’ (attributed to Benjamin Franklin).

A certain degree of stubbornness is found in holding to the conventional assumption that irresponsible conduct is associated with reputational penalties. In addition to the intuitive appeal and rhetorical attractiveness of the idea, a significant tranche of empirical research has provided evidence consistent with the accepted wisdom. Much of this research demonstrates that irresponsible conduct is associated with significant declines in firms’ stock market valuations identified through event study methods (Karpoff *et al.*, 2005, 2008). Typically, in such studies, the stock market valuation decline is as big or bigger than the direct costs of irresponsibility borne in the form of fines or settlements and is thus argued to represent a reputational penalty. Similarly, experiments done on consumer behaviour suggest a strong willingness to punish irresponsible firms by not buying products from these brands (Sweetin *et al.*, 2013). Consumers will often share negative social evaluations through word of mouth, thereby amplifying these reputational effects (Grappi *et al.*, 2013). Likewise, top managers associated with scandals or irresponsible behaviour related to fraud or financial irregularities do face greater opposition within the board or higher risk of turnover, at least under certain conditions (Cowen and Marcel, 2011; Ertimur *et al.*, 2012). In contrast to prevailing literature, this Discussion Forum is dedicated to the topic of how negative actions fail to provoke reputational sanctions and may coexist with persistent good reputations.

	Bad Reputation	Good Reputation
Negative Action or Evaluation (‘Doing Bad’)	Conventional hypothesis	Our topic
Positive Action or Evaluation (‘Doing Good’)		Conventional hypothesis

Figure 1 Responsibility, irresponsibility and reputation research.

3. Irresponsible behaviour and reputation: some exploratory evidence

Notwithstanding the empirical evidence discussed above, the pervasive and persistent nature of corporate irresponsibility suggests that reputational sanctions may be weaker than commonly assumed. To get a handle on this issue, we provide here some tentative and exploratory empirical evidence on the association between irresponsibility and reputation. We examine US firms during the period 2006 to 2012, combining data from two widely known sources. First, we use the reputation index available within Fortune's World's Most Admired Companies research. Second, we link these to the KLD database on CSR, using the items on 'concerns' as a proxy for corporate irresponsibility. The resulting panel gives us a data set of 1776 firm-year observations. The strengths and limitations of each of the respective data sets are well known to many empirical researchers in these fields (Mattingly and Berman, 2006; Dowling and Gardberg, 2012). The default hypotheses assumed in most literature is that irresponsible conduct will be associated with rapid and dramatic reputational consequences. To the extent that the prevailing perspective holds, we ought to see quite strong evidence even in the basic descriptive analysis done here.

We first compare the reputations of firms that have experienced significant instances of irresponsibility with those that have not. The evidence suggests that those firms associated with irresponsibility have slightly better reputation scores than those not associated with irresponsibility—reputational scores of 6.30 and 6.26, respectively, a difference statistically significant at the 95% level.

A next piece of analysis brings further granularity to the association between reputation and irresponsibility by describing the reputational characteristics of firms grouped according to how many acts of irresponsibility they are associated with in a given year. Table 1 provides descriptive statistics for firms grouped into quartiles according to the number of concerns (instances of irresponsible conduct) associated with a firm in a given year. Firms in the fourth quartile have

Table 1 Firm reputation by number of KLD concerns (quartiles), Descriptive Statistics, 2006–2012

	Fewest concerns		Most concerns	
	First quartile	Second quartile	Third quartile	Fourth quartile
Average reputation score	6.22	6.20	6.23	6.47
SD	0.83	0.95	1.01	0.93
Minimum	3.76	2.65	2.31	3.20
Maximum	8.21	9.14	8.77	8.77

the most concerns (on average a little more than seven concerns each), with firms in Group 1 having the least concerns (on average fewer than one each). What is striking is that firms with the highest incidence of irresponsibility have significantly better reputations than the firms in the first three quartiles of concerns.

A further descriptive investigation explores whether recognizing the heterogeneity of irresponsible conduct helps to provide additional evidence in relation to the absence of an aggregate reputational penalty for irresponsibility. Do such penalties apply only to certain forms or domains of irresponsibility? The evidence presented in Table 2 suggests not. Separating corporate irresponsibility into six constituent issue/stakeholder domains and comparing the average reputation of firms that are and are not associated with particular forms of irresponsibility fails to provide strong evidence that irresponsibility is accompanied by reputational penalties—only two cases show statistically significant effects: firms that experience environmental irresponsibility have better reputations than firms that do not, and firms that are linked to diversity-related irresponsibility have significantly worse reputations.

Next, it is useful to examine the year-on-year changes in reputation (rather than comparing the *levels* of reputation) associated with instances of irresponsibility. Partly, this reflects a need to address possible sample selection effects—prominent and highly visible firms that are more esteemed tend to attract greater scrutiny and thus their transgressions are more likely to receive attention—and partly studying changes helps address possible endogeneity of the relationship between corporate irresponsibility and reputation. Table 3 replicates the analysis reported in Table 1, but replaces the comparison of average levels of reputation across groups with average changes in reputation relative to the previous year. The evidence in Table 3 demonstrates that, on average, the reputation of firms in all four groups declined—this is an artefact of the period of study (2006–2012) within which global financial crisis and recession contributed to weaker reputations across the

Table 2 Average reputation of firms with and without KLD concern, by domain

Category of concern	Concern present	
	No	Yes
Governance	6.30	6.23
Community	6.24	6.28
Diversity	6.31	6.16
Employee relations	6.24	6.26
Environment	6.22	6.31
Product	6.24	6.26

Table 3 Changes in reputation by number of KLD concerns (quartiles)

	Fewest concerns		Most concerns	
	First quartile	Second quartile	Third quartile	Fourth quartile
Mean	-0.03	-0.10	-0.08	-0.05
SD	0.50	0.53	0.60	0.60
Minimum	-1.90	-1.73	-3.10	-2.44
Maximum	1.27	2.00	2.02	2.24

corporate sector. At the same time, the evidence shows that the decline in reputation experienced by firms with the highest levels of irresponsibility is not significantly higher, or lower, than that experienced by firms less associated with irresponsibility.

Lastly, some areas of irresponsibility are likely to be 'old news', making it is useful to examine how firm-level changes in the number of instances of corporate irresponsibility relate to reputation. This analysis is presented in Table 4, which provides group means for the level and change in reputation relative to the prior year according to whether the number of concerns a firm was associated with increased, stayed the same or reduced relative to the previous year. Once again, average changes in reputation are negative, reflecting weak wider economic conditions. What is striking is that, on average, firms experiencing an increased number of concerns have better reputations than other firms and experience falls in their reputations that are not statistically different from those that have stable or improved records in relation to corporate irresponsibility.

To briefly summarize, in contrast to the accepted wisdom, our analysis provides very little the evidence for sharp reputational penalties associated with instances of corporate irresponsibility. In fact, firms associated with the highest levels of corporate irresponsibility have the best reputations and experience among the lowest year-on-year declines in reputation in the year subsequent to instances of

Table 4 Reputations and changes in the number of concerns associated with firms

	Reputation score in year subsequent to irresponsibility	Change in reputation score relative to prior year
Firms with an increased number of concerns	6.43	-0.07
Firms with a constant number of concerns	6.20	-0.12
Firms with a reduced number of concerns	6.36	-0.01

irresponsibility. Additionally, the presence of irresponsibility is associated with significantly better reputation for environmental issues. Only in relation to diversity-related instances of irresponsibility is there any statistically significant evidence of a reputational penalty. Overall, the sizes of the effects identified are small and seldom statistically significant. This evidence, though admittedly crude, does pose some puzzles in relation to whether, how, and when corporate irresponsibility carries reputational penalties.

4. Constructing irresponsibility: grey areas

The evidence above raises important questions on how stakeholders construct social evaluations of irresponsible actions, and how these ultimately influence corporate reputation. In fact, prior research in business ethics already provides a rich discussion of the ambiguity, contingency and uncertainty involved with evaluating and acting upon instances of irresponsibility. While prominent cases of irresponsible conduct tend to occupy our attention, they are often only the surface phenomenon. Behind them may lay a longer and more sustained set of irresponsible actions that remain undiscovered by the public. These corporate activities reside in what might be termed ethical 'grey areas'. 'Grey areas', exist at 'the border between two or more things that are undefined, hard to define, impossible to define, or where the border changes. In ethics [grey areas exist] where the border between right and wrong is blurred' (Bruhn, 2009, p. 206). Grey areas defy categorical understandings of legitimacy such that actors inhabit an ambiguous or contested zone of social judgment. Here, actors may face many different shades of grey, where individuals and organizations seek to make sense of behaviours by making them comparable, and establishing social reference points for ethical judgments.

At the most basic level, research demonstrates that even whether a given act is or is not 'irresponsible' or 'unethical' is often contested and open to interpretation within a given social context. In that sense, 'irresponsibility', much like reputation, is a socially constructed phenomenon. Scholars have highlighted that economic, social and technological change have all contributed to a reduced consensus regarding morality and ethical judgments as well as how culture plays a hugely significant role in shaping evaluations of responsibility and irresponsibility (Thorne and Saunders, 2002). Individuals' interpretations of ethical issues are heavily mediated by a range of factors including media framing effects, personal moral intensity, training and professional background and experience.

Beyond the irresponsibility of a given behaviour, research has highlighted that establishing corporate culpability in relation to an event is often non-trivial. Reputational assessors care not only that a given benefit or harm arose, but are also concerned to divine the motivations and intent of the actors involved (Godfrey, 2005). Moreover, the potential and presence of grey areas can provide companies with

opportunities to communicate so as to distance themselves from events by offering competing narratives and explanations (Bruhn, 2009).

Lastly, research has demonstrated that most organizations may both engage in controversial activities and, at the same time, adopt practices aimed at social responsibility, even if only to the extent that the costs and benefits of doing so constitute a good 'business case' for their company. Hence, publics are faced with competing, often conflicting bundles of good and bad contributions to evaluate in relation to making an overall reputational assessment.

This process is often difficult. Looking at contemporary popular culture, the book 'Fifty Shades of Grey' did not earn its author EL James a great reputation in terms of literary accomplishment, but did make her the highest earning author of 2012 at \$95 million. Meanwhile, the book remains ethically controversial—being subject of frequent library complaints in the USA or condemned as misogynist or abusive towards women.³ A more central example of corporate behaviour concerns tax aggressiveness. Companies such as Starbucks or Amazon have been widely criticized for their use of subsidiary firms and inflated transfer pricing to pay almost no corporate tax in the UK. For example, Starbucks accounting showed that its 700 UK outlets generated no profits. In fact, UK subsidiaries were charged inflated transfer prices by their coffee trading subsidiaries in Switzerland, which realized these profits but only paid 12% in corporate taxation compared with the higher 20% UK rate.⁴ Although not illegal, Starbucks behaviour faced a wave of reputation damaging criticism. Responding to these allegations, Starbucks was perhaps the first company to alter its tax behaviour, unlike Amazon and Google⁵, and has managed to maintain a second place ranking in the Fortune Ranking as the company most admired for its social responsibility in 2013.

These examples are interesting in showing how ethical grey areas describe actions that are not illegal and which may even be celebrated, at least by some. At the same time, these ethical grey areas carry potential risks or impose externalities on other parties. For example, when faced with criticism, corporations may simply move their controversial activities overseas to jurisdictions with weaker rules of the game, or where these activities are less visible to powerful corporate stakeholders or the media (Surroca *et al.*, 2013). This response may perpetuate problems and impose further externalities. Consequently, the likelihood that irresponsible actions will be sanctioned may decrease since stakeholder motivation and media

³See <http://www.theguardian.com/society/2012/aug/25/fifty-shades-submissive-sophie-morgan> (accessed on September 27, 2013).

⁴See <http://www.theguardian.com/business/2013/jun/23/starbucks-pays-corporation-tax> (accessed on September 27, 2013).

⁵See <http://www.theguardian.com/news/datablog/2013/jul/15/reputation-management-business-swallow-bitter-pill> (accessed on September 27, 2013).

coverage weaken, and perhaps more alarming, the corporation may disassociate itself from responsibility over the issue and act in denial of the associated risk (Reuber and Fischer, 2010).

In sum, ethical grey areas are important in two inter-related ways. First, stakeholders or the public may have difficulty evaluating these behaviours in ethical terms. Even if stakeholders become aware of them, they are unlikely to react strongly and apply negative sanctions. Second, by tolerating ethical greyness, corporations are likely to move further along a slippery slope towards a larger scale and more overt forms of irresponsible behaviours—which are very pervasive, as we have argued above. Indeed, the ambiguity of these behaviours or the glossing over of irresponsible actions with more overt responsible ones may act as a form of social control that allows ethical distancing of corporate insiders, and further perpetuation of irresponsible actions (Costas and Kärreman, 2013).

5. Shades of grey: the diverse reputational dynamics surrounding corporate irresponsibility

The study of corporate reputation needs to account for a surprisingly weak relationship between irresponsible behaviour and corporate reputation. Indeed, many firms have high reputations despite being subject to negative evaluation or being involved in irresponsible behaviours. Similarly, a negative evaluation or uncovering of irresponsible actions is not itself a sufficient condition to produce a reputational penalty. Indeed, many social actions are not strongly sanctioned. Negative evaluations are important, but not sufficient to produce reputational outcomes. Part of the puzzle reflects a basic but neglected asymmetry: the relationship between positive social actions and good reputation is not the same as between negative social actions and bad reputation.

In addressing these issues, the contributors to our Discussion Forum were invited to write short papers outlining insights from their own research on irresponsibility and reputation. The first paper by Jonathan Karpoff introduces the notion of grey areas from an economics perspective. While market incentives may work to reward some socially desirable behaviour and sanction some socially undesirable behaviour, Karpoff examines the market incentives associated with failures to reward good behaviour or sanction bad behaviour. Reviewing econometric evidence, he finds substantial losses in market value in cases where the direct counter-parties of the firm are affected. But equally, one more unsettling finding is that reputational penalties are far weaker or non-existent in cases where salient stakeholders of the corporation are not directly and negatively affected. In particular, reputational penalties seem to be weakest regarding environmental violation and cases of foreign bribery.

Several of the contributions in this Discussion Forum stress the role of individual-level factors and processes surrounding social evaluations. Lange

emphasizes how reputation is influenced by the potential disjuncture between irresponsible behaviours and the process of social attribution. Attribution reflects three key factors: the evaluation of behaviour as having effects that are highly undesirable, the complicity or non-complicity of affected parties with their fate and the clarity or ambiguity of causal links between corporate actions and the negative effects. Donald Lange's essay shows that these links may often be only loosely coupled, thus weakening the relationship between irresponsibility and reputational sanction. Looking at the debates over head injuries in the National Football League (NFL) in the USA, Lange emphasizes the role of discourse, where attributions of irresponsibility are interpretively established but also contested by various actors with the field. Along complementary lines, Anastasiya Zavyalova examines how stakeholders evaluate negative events or irresponsible behaviour. She identifies three major contingencies: (i) the role of stakeholder expectations from the organization, (ii) the role of wrongdoing by competitors and (iii) the role of stakeholders' identification with an organization. These aspects suggest some potentially counter-intuitive dynamics, whereby having a high reputation may result in negative consequences and negative events can have positive outcomes. For example, high reputations may be a liability in terms of inflated stakeholder expectations or increasing the likelihood that stakeholders view corporate behaviours as hypocrisy. Zavyalova also reminds us how social evaluations are very relative in nature. Stakeholders may shift their evaluations as the overall prevalence of negative or irresponsible behaviours increases among peer firms (for example, see the study of downsizing by Love and Kraatz, 2009). Similarly, social identities and the strength of prior identification with a firm may mediate whether stakeholder responses are characterized exit, voice or loyalty (Hirschman, 1972).

The contribution by Brooke Harrington builds directly on the previous discussion of micro-level social evaluation, but places these considerations in a broader macro-level narrative of the historical context. By revisiting her extensive work on retail investors, Harrington argues that social frames of evaluation change systematically over time. In particular, she documents a shift in evaluative frameworks from the more optimistic period of the 1990s to a more cynical and negative post-Enron era. Whereas individual investors initially paid close attention to the legitimacy of corporate behaviour and make investment choices based on positive associations with their individual identity, the spread of irresponsible behaviour leads to a shift in evaluations away from a standard of legitimacy and towards a more relativistic evaluation of corporate reputations. As investors make choices between the lesser of two evils among a field of illegitimate organizations, Harrington shows the strong and negative consequences on these individuals' self-evaluation and revision of their identities—from victims to accomplices in irresponsible actions.

The legal analysis provided by Frank Partnoy examines six shades of grey in how the law relates to irresponsible corporate behaviours. His essay reviews six themes: the optimality of bad behaviour, alegality, *ex ante* specification of standards, regulatory arbitrage, *ex post* assessment and regulatory licences. By applying these concepts to examples from the arena of financial regulation and the current crisis, Partnoy shows the complex relationship between law and reputation. In short, legal norms often frame irresponsible behaviour in ambiguous ways—such as when a market transaction is not illegal, but simply falls into an alegal or unregulated area. Similarly, the effects of reputation on limiting unethical behaviour may be weak in cases of regulatory licence, where private standard setting agencies receive public sanction as oligopoly. An excellent example here is the role of credit ratings, whose opinions become part of regulatory rules governing the behaviour of investors despite the relatively weak evidence of their effectiveness in rating certain types of financial instruments (see also Carruthers, 2013). Partnoy also forwards an interesting converse argument—if uncertainty is strategically used by regulators in their *ex post* application of principles, the existence of grey areas may be an effective deterrent to bad behaviour.

The essay by Brayden King looks at the role of reputation from the perspective of private governance. He stresses that unlike regulatory models based on legal rules and enforcement by the state, private governance pre-supposes a very strong role for reputation. However, the social and political construction of reputation within a field can be highly contested. One such area concerns certification, which aims at making social or ecological actions of firms comparable and signalling the quality of actions to external stakeholders. As the number of certifications has proliferated, King observes growing contention over what constitutes ‘good’ standards, trade-offs between looser standards with high adoption versus stricter and more exclusive standards. King highlights the role of activist groups and the media in mobilizing public sentiment manifesting itself in reputational penalties. The dynamics of mobilization, however, may entail targeting of highly visible firms rather than the most egregious behaviours, and in the worst case simply focus corporate efforts on impression management more than substantive change.

The final piece by David Deephouse applies many of the previous concepts and arguments in a very personal view of Apple. In a charming narrative of his experiences as a stakeholder over several decades, Deephouse’s experience parallels the evolution of the company from a small and innovative start-up to a major global electronics company. He reflects on how his own perception of the company has changed, being framed by his past experience with the company and also changing societal expectations. As Apple has been associated with a growing number of grey areas, so its reputation has become more ambiguous and increasingly contested.

The Discussion Forum suggests a rich topography of mechanisms that may help challenge conventional wisdom of research on reputation, and helps unpack under

what conditions socially irresponsible corporate actions are likely to result in reputational penalties. Doing so has strong implications for literatures on private governance, where interfaces with market mechanisms point to micro-processes surrounding the expectations and evaluations of salient stakeholders. Social attributions of irresponsibility are shaped, in turn, by social psychological perceptions and identification with the firm. Similarly, it is crucial to understand the role of reputation at the field level or even more macro-level processes, where historical contingencies play a greater role. The frame of reference for social evaluations is itself socially constructed, and influenced by prevailing institutions and changes in those institutions. Taken together, bringing together the micro and macro aspects of reputation seems a promising avenue for research that will better understand both managerial aspects of reputation and private governance, particularly as they relate to the darker sides of corporation behaviours.

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The grey areas of firm behaviour: an economic perspective

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Firms do some things that are profitable, and some things that contribute to the greater good. Adam Smith's Invisible Hand is the idea that profitable activities and socially desirable activities are frequently one and the same.¹ It is popular to scoff at the Invisible Hand (e.g. see [Hardin, 1968](#)), but Smith's articulation of it remains one of the most important discoveries in the history of social science. It explains not just how we get our daily bread (which was one of Smith's examples) and the iPhone (which might be his example today), but more fundamentally, how wealth is created and how humankind has escaped the penury of autarky.

Not everything that is profitable for businesses, however, is good for the rest of us. Firms can profit by polluting, defrauding customers or investors, bribing government officials, reneging on contracts with employees or holding up payments to suppliers. Moreover, there are many socially beneficial things that firms do not do because they are not profitable, such as investing in basic research, giving more to charity or adhering to stricter environmental guidelines than required. Stated differently, profitability and social desirability are not perfectly correlated. Activities in which profitability and social desirability do not coincide are the grey areas of business behaviour. These are the activities that can, and indeed *must*, be guided by forces other than their apparent profitability to firms.

This paper examines these grey areas and the inducements firms have to exploit or avoid them. Recent research offers reasons for both hope and concern. On the hopeful side, it turns out that the Invisible Hand has a longer reach than we might first anticipate, as firms and managers face powerful private inducements to avoid many socially harmful activities such as fraud and misrepresentation. This implies that many 'grey activities' are really not so grey, in the sense that firms that act badly end up hurting their bottom lines as well. Of concern, however, is the finding that such private market inducements are weak for some types of activities, including environmental harms and bribery. There remain

¹See [Smith \(\[1776\] 1963\)](#), Book IV, chapter II, paragraph IX. The context in which Smith uses the term 'invisible hand' has yielded debate over his exact meaning, but here I refer to its most popular definition, which is what Friedman called 'the possibility of cooperation without coercion' (see <http://www.econlib.org/library/Essays/rdPncI0.html#Introduction,%20by%20Milton%20Friedman>).

strong financial incentives to pollute or bribe, implying that these harmful activities can be controlled only through moral suasion or legal enforcement. A further concern is the widespread use of the political process to shift costs onto others. This encourages firms to invest resources to make profitable some types of socially harmful activities that they otherwise would not pursue.

Figure 1 provides a picture of the grey areas of business activity. The first quadrant ('Quadrant I') in the figure reflects productive activities that are both socially desirable and profitable for firms to pursue. These are activities for which Smith's Invisible Hand works well. These productive activities explain how we each get our morning coffee, the tablet on which you might be reading this essay and the running shoes lying by my front door. In each case, someone—or a lot of someones—diverted their energy and resources into making something that the rest of us find valuable. Mostly, these producers do not provide their services because they know about our specific needs for coffee, computers or exercise. Rather, they provide these services because they want to make a buck and further their own needs and desires. The fact that they benefit a lot of other people along the way is the magic of the Invisible Hand.

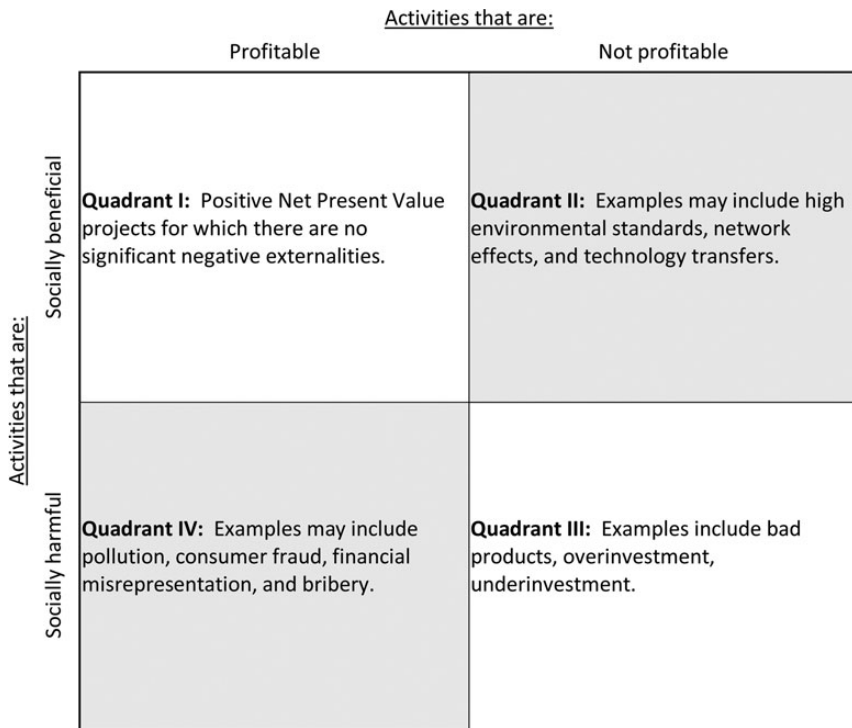


Figure 1 The grey areas of business decision-making.

Quadrant III represents activities that are neither individually profitable nor socially desirable. Just like the Invisible Hand encourages activities in Quadrant I, it discourages activities in Quadrant III. This is because many undesirable activities are also not profitable. Examples include diverting valuable resources into low-valued products, abandoning a research project on the verge of a commercially valuable breakthrough or overworking employees to the point that the firm's product quality suffers. To be sure, many activities that should be in Quadrant III persist, but only because the people who benefit from the activities can shift the costs onto others and effectively move the activities into Quadrant IV. As an example, some managers consume perquisites on the job that are only modestly valuable to them compared with the costs imposed on shareholders (e.g. see Demsetz, 1983).² As another example, firms can use the political process to capture benefits from activities that are socially wasteful and that would be unprofitable except for governmental intervention. Examples include most ethanol production in the USA, steel production spurred by tariffs and sugar production in Florida.³

The activities represented in Quadrants I and III are the focus of more than 200 years of research by economists, political scientists and other social scientists. They have given rise to general equilibrium models of production, the theory of firm organization and corporate governance and public choice theory. The foci of this essay, however, are activities that fall in the grey areas—Quadrants II and IV. Quadrant II captures socially beneficial activities for which private incentive is insufficient to bring them about. This is the case of positive externalities, which may include some research activities, network effects and technology transfers. Quadrant IV captures activities for which the Invisible Hand does not work well, including negative externalities and monopoly pricing.

1. What forces are at work in the grey areas?

To repeat, Quadrants II and IV are grey areas of business conduct. These are the activities that firms do too little of (Quadrant II) or too much (Quadrant IV). Figure 2 illustrates one way to characterize the goal of our collective research and policy efforts: we seek to push the activities that currently reside in Quadrant II into Quadrant I, so that firms voluntarily will undertake them. And we want to push the activities that currently reside in Quadrant IV into Quadrant III, so that firms voluntarily will refrain from them.

²As one of many examples, Yermack (2012) shows that many corporate managers employ corporate jets, leisure time and other perquisites that do not serve shareholders' interests.

³There are, of course, defenders of ethanol, steel and sugar subsidies and mandates. But most independent analyses conclude that the economic and environmental costs of these policies outweigh their benefits (e.g. see Hahn and Cecot, 2009).

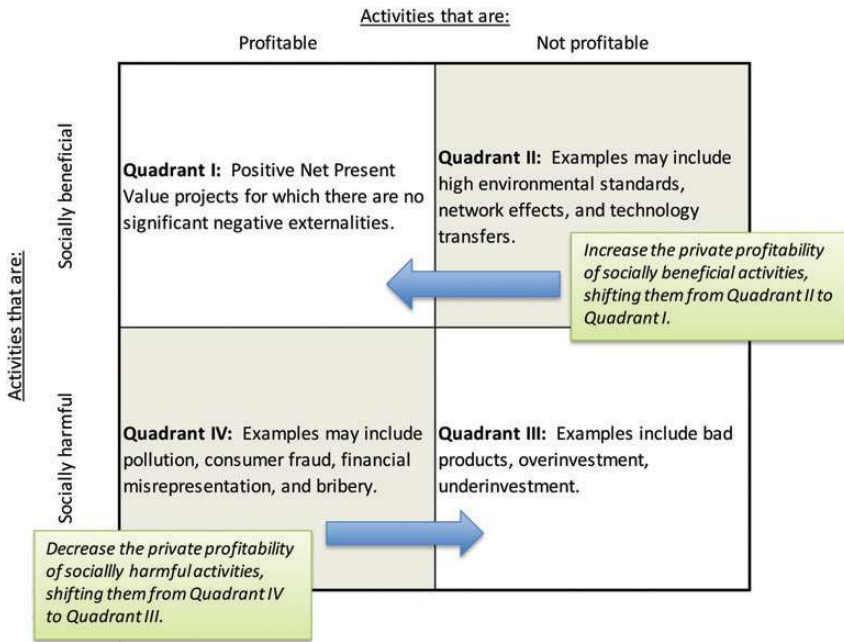


Figure 2 Representation of research and public policy goals.

There are three broad forces that encourage managers and their firms to do more Quadrant II activities and fewer Quadrant IV activities. The first is a community’s laws and regulations. Most of the legal system is designed to increase the private penalties for activities in Quadrant IV, to decrease the incentive to engage in fraud, theft, misrepresentation, worker exploitation or other socially costly activities. Government influence also is used to increase the private incentives for Quadrant II activities, as when governments subsidize education or basic research.

A second inducement for firms to do more Quadrant II activities and fewer Quadrant IV activities is each manager’s moral code, that is, his or her personal commitment to integrity and fair dealing. Such personal commitment may reflect the manager’s personal philosophy or religious beliefs, as well as community norms and expectations. We all know businesspeople who put in extra effort even when it is not required or likely to be compensated, or who refrain from wasteful activities such as dumping effluent in the city’s storm sewers, simply because it is the right thing to do. As J.C. Watts observed, ‘Character is doing the right thing when nobody is looking’, and character no doubt plays a large role in constraining such activities as pollution and fraud even when they appear to be privately lucrative.

The third primary inducement for firms to behave well is reputation. Reputation has many meanings and uses, but here I refer to the economic definition provided

by Karpoff (2012, p. 363), in which reputation is ‘the present value of the cash flows earned when an individual or firm eschews opportunism and performs as promised on explicit and implicit contracts. Stated differently, reputation is the value of the quasi-rent stream that accrues when counterparties offer favorable terms of contract because they believe the firm will not act opportunistically toward them’. In theory, reputational benefits may accrue to firms that pursue socially desirable activities, including those that are not profitable, and to firms that refrain from socially harmful activities even when they are profitable. The evidence indicates that such benefits are real and large for some types of activities, but not for others. The following sections discuss the empirical evidence regarding the role that reputation plays in disciplining bad behaviour and encouraging socially desirable behaviour.

2. When does reputation work to police the grey areas?

2.1 Reputation shifts some Quadrant IV activities into Quadrant III

Karpoff (2012) surveys more than 50 empirical research papers that examine the impacts on firms that are caught engaging in activities that appear to fall in Quadrant IV. These include financial misrepresentation, false advertising, product recalls, consumer fraud, air safety failures and defence procurement fraud. Firms that engage in misconduct that affects their counterparties—for example, lying on financial reports or defrauding consumers—experience large decreases in value. These firms’ losses far exceed the direct costs of the misconduct, including the costs of lawsuits and legal penalties. Further evidence indicates that the losses correspond to subsequent decreases in future cash flows and/or increases in these firms’ costs of capital.⁴

These results indicate that misconduct affecting a firm’s counterparties tends to trigger large reputational losses. In the case of financial fraud, for example, the reputational loss averages 25% of the firm’s market capitalization, an amount that is 7.5 times the losses imposed through regulatory penalties and lawsuits (Karpoff *et al.*, 2008). The losses are not temporary; rather, they reflect investors’ expectations of these firms’ higher costs and lower revenues as investors and customers shy from doing business with firms that have lax internal controls or a culture of opportunism (see Graham *et al.*, 2008; Murphy *et al.*, 2009). The large reputational losses imply that the *ex post* profitability of opportunistic behaviour tends to be negative for firms that are caught. The *ex ante* profitability depends on the probability that these firms are caught, but the overall effect of reputational penalties is to shift these

⁴Most of the surveyed papers use event study methods to measure the share price reactions to initial news of the misconduct, and to subsequent revelations about the severity and consequences of the misconduct. In general, the share price reactions do not reverse over longer event windows but rather, represent losses in present value that subsequently show up in lower revenues and higher costs.

activities from Quadrant IV towards Quadrant III, making unprofitable many types of misconduct that are socially harmful.

While reputation plays a large role in disciplining some opportunistic behaviours, its importance can be overlooked by executives and policymakers. Ford Motor Company's infamous 'Pinto memo' is a case in point. In the early 1970s, Ford submitted a document to the National Highway Traffic Safety Administration—later dubbed the 'Pinto memo'—seeking exemption from proposed safety standards. The memo concludes that the cost of meeting the standards would be much higher than the value of the lives that possibly could be saved if the standards were met.⁵

At roughly the same time, Ford marketed its Pinto automobile as a fuel-efficient competitor to the Volkswagen Beetle and Toyota Corolla. The Pinto's design, however, made it vulnerable to gas tank ruptures in rear-end collisions, increasing the likelihood that even a small accident could lead to serious personal harm or death for the car's occupants. Ford delayed recalling the Pinto to fix this problem until 1978, after several highly publicized crashes that resulted in tragedies. The 'Pinto memo' was not directly related to the Pinto's gas tank problem, but it became a symbol of Ford's apparent willingness to sacrifice customer safety for profit. When news of Pinto-related deaths began to circulate, Ford received terrible publicity that contributed to a company-wide decrease in sales. In the ensuing years, Ford Motor Company nearly failed as an independent company.

The 'Pinto memo' reads like a competently executed benefit–cost analysis. But it had a major flaw—its authors did not consider Ford's reputational costs if consumers began to consider its vehicles as unsafe. In hindsight, we can see that Ford's decision to not recall and fix the flawed Pinto in a more timely manner was not in Quadrant IV, as its executives apparently thought. Rather, it was in Quadrant III. That is, the decision to not protect Ford's customers ended up hurting the company's bottom line. By not taking into account the value of a good reputation and the reputational loss that would accrue as customers fled to other automakers, Ford's executives perversely pursued a value-destroying strategy.

2.2 Reputation does not work to police all Quadrant IV activities

As summarized by Karpoff (2012), however, not all types of misconduct are shifted from Quadrant IV to Quadrant III by the force of reputation. This is because reputational losses are small to negligible for environmental violations and other misconduct that does not directly affect the firm's counterparties. Karpoff *et al.* (2005), for example, find that firms that violate environmental regulations suffer significant losses in share values that average 1% of market capitalization. These

⁵The memo is available at <http://www.autosafety.org/ford-pinto-costbenefit-memo>. For an analysis of Ford's and regulators' actions relating to the Pinto, see Lee (1998).

losses, however, are completely attributable to the fines, penalties and remediation costs imposed on the polluting firms. A firm that dumps effluent into a river, for example, imposes costs on downstream users. If caught, the firm typically faces substantial fines, lawsuit settlements and cleanup costs. But in most cases the firm's dumping activities do not directly affect its customers, suppliers or investors. These counterparties do not face the prospect of direct harm from the firm's willingness to behave badly, so they do not have incentive to change their terms of contract with the firm. As a result, we do not observe a general tendency for environmental misconduct to harm firms' reputations with their counterparties. Using the framework proposed by [Mitchell *et al.* \(1997\)](#), reputational consequences that directly affect firm value and operations arise only when the affected stakeholders have salience. The firm is less likely to internalize any costs it imposes on the firm's 'dependent stakeholders' because these stakeholders do not have a business relationship with the firm.

[Karpoff *et al.* \(2013\)](#) find that the reputational loss for foreign bribery also is negligible. They infer that the revelation of bribery does not adversely affect the firm's counterparties, who therefore have no direct incentives to shy from doing business with the firm. To the extent that bribery is socially harmful—undermining the rule of law and the role of trust in market contracting, for example—bribery fits squarely into Quadrant IV. In fact, we can think of Quadrant IV as consisting of all such activities that impose net social harms that are not deterred by reputational penalties.

2.3 Quadrant II

The threat of penalties, via either the market or the legal system, helps to decrease the grey area of Quadrant IV. Are there commensurate rewards to firms that undertake activities in Quadrant II? One line of research that seeks to address this question examines whether firms that adopt environmentally sensitive policies enjoy abnormally high profits, values or other benefits. In contrast to the mounting evidence of reputational losses for certain types of misconduct; however, here the research findings are mixed. Some researchers find evidence consistent with green policies being rewarded with increased profitability (e.g. [Amore and Bennesen, 2013](#)). Other studies, however, conclude that environmentally friendly policies are unrelated to profitability, are the result rather than the cause of firm profitability or are associated with poor performance (e.g. [Hong and Kacperczyk, 2009](#); [Climent and Soriano, 2011](#)). Given such conflicting findings, this is a ripe area for further research.

While the research is mixed on whether there are private rewards for environmentally sensitive investment, a second line of research examines the extent to which private contracting allows firms to capture the external benefits of their actions. A widely cited textbook example of an activity that allegedly falls in Quadrant II is beekeeping. According to the theory, beekeepers provide uncompensated

pollinating benefits to orchard owners—an example of an external benefit that could be resolved through public subsidies for beekeeping. Cheung (1973) examined this popular example by obtaining data on actual contracts between beekeepers and orchard owners. Contrary to the archetypal story, he finds that beekeepers do in fact capture the benefits of their bees' pollinating services. This implies that some types of activities that are suspected to reside in Quadrant II are, in fact, better characterized by Quadrant I.

A third approach has been to examine the role of public subsidies for Quadrant II activities. In theory, subsidies would better align firms' private benefits with the public benefits of such activities. Economics textbooks typically cite subsidies for education and basic research as examples of policies that encourage socially desirable investments when private incentives are insufficient. Current policy debates over subsidies for alternative energy sources reflect disagreements over whether investments in such sources are best characterized by Quadrant II or III. Advocates of such subsidies claim that they fall in Quadrant II and therefore should be encouraged, while critics claim that they fall in Quadrant III and should not be encouraged.

3. Lessons and takeaways

This paper suggests a framework for characterizing the grey areas of business behaviour. These are activities that are either socially desirable but not profitable or profitable but not socially desirable. This brief discussion leaves out many important details, including how to determine the social desirability of any particular activity, whether individual incentives align well with those of the organization, and the frictions that arise when it is costly to attribute blame for irresponsible acts. Existing research nonetheless sheds light on three important lessons.

3.1 Lesson 1

The number of activities that fall in the grey areas is smaller than it first appears, because private contracting and reputation work to encourage many beneficial activities and discipline many harmful activities. In particular, the costs of many harmful activities are internalized through the perpetrating firm's lost reputation. To be sure, the prospect of lost reputation does not deter all business misconduct. But for many types of misconduct, such as financial or consumer fraud, empirical measures of lost reputational capital are several times the value of all legal penalties imposed on the firm, implying that lost reputation is a primary source of deterrence.

3.2 Lesson 2

There remain grey areas in which the Invisible Hand does not work well. These persist in part because harms are imposed on parties that are outside the nexus

of counterparties with whom the perpetrating firm does business, so no market-based mechanism exists to force the firm to internalize the costs of its bad behaviour. Available evidence indicates that environmental damage and foreign bribery fall in this category.

3.3 Lesson 3

The grey areas present important questions for further research. Here are four examples: (i) the fact that firms continue to be exposed for unethical or illegal activities indicates that laws, ethics and reputation are insufficient to deter all harmful activities. To what extent do managerial incentives, agency problems or executive mistakes cause firms to pursue these activities? (ii) How and to what extent do private contracting, public policy and private charity incentivize firms to engage in socially desirable activities that currently fall in Quadrant II? (iii) How can public policy take into account the role that reputation plays in disciplining some harmful activities, effectively shifting them from Quadrant IV to Quadrant III? (iv) How do agency costs and political cost shifting work to (perversely) move some Quadrant III activities into Quadrant IV?

Acknowledgements

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How do we come to the conclusion that an organization has acted socially irresponsibly? Some considerations on the process of attribution and the issue of head injuries in the NFL

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If we allow for the idea that there are certain corporate behaviours that are measurably socially irresponsible given our commonly held notions of right and

wrong, then we can also allow for the idea that there are certain corporate behaviours that simply should accrue reputational penalties. Yet often they do not. This points to how interesting the concept of reputation is. Reputation is often spoken of as an asset, a feature or a property of the organization, but it is an unusual type of organizational property in that it exists only as an understanding in the minds of beholders. Reputation is the perceptual representation of the organization that develops among its observers over time as they make sense of the organization's behaviours and outcomes. It is therefore a function not only of the concrete actions and performance of the organization, but also of observers' expectations and interpretations, which are themselves a product of social construction and individual cognitive processes. As a result, it is hard to truly understand corporate reputation without understanding its micro-level underpinnings. Corporate reputation exists in the perceptions of the individual observer who is immersed in a social context, and nowhere are these micro underpinnings of corporate reputation more evident than in the way that the individual observer forms, or does not form, attributions that a corporation has acted in a socially irresponsible manner.

Attribution is the cognitive process by which the observer explains the organization's behaviours and outcomes as a function of organizational and/or situational factors. In a recent article, Washburn and I discussed how attributions of corporate social irresponsibility are formed (Lange and Washburn, 2012). We described how perceptions of irresponsibility will be undermined if the observer does not view the effect of corporate behaviour as highly undesirable, if the affected parties appear complicit in their own fate, and/or if the corporation's causality or moral responsibility for the effect is ambiguous. Corporate social irresponsibility attributions are more likely to develop when observers see the effect of corporate behaviour as personally threatening and a violation of strong norms and when the effect is unexpected and concentrated in time and space. Irresponsibility attributions are also more likely to develop when the victim of the effect seems innocent and unable to avoid the effect, and when the corporation seems to have freely and consciously made the choice to engage in damaging behaviour. A key point here is that attributions of social irresponsibility do not necessarily align perfectly, or sometimes at all, with 'objective' notions of social irresponsibility. The processes of attribution therefore help explain the loose coupling between corporate bad behaviour and reputational penalties, as understandings as to what constitutes bad or irresponsible behaviour are not fixed and factual but rather are in flux based on the idiosyncrasies of situations and perceivers.

Occasions for attribution are most acute when new potentially negative information about an organization's past, current or intended actions surfaces, or when new negative interpretations of the organization's behaviour are emerging

in public discourse. Thus, news of potential labour abuses at Apple, Inc.'s Chinese subcontractors, allegations of unintended acceleration problems in Toyota vehicles, and ongoing discussions of the deleterious economic aftereffects of the mortgage industry meltdown are all fodder for potential attributions of corporate social irresponsibility, as are countless other occurrences and controversies in the news.

By way of illustration, consider how the emerging controversy about long-term ill effects to players in the game of American football because of head injuries presents an occasion for possible corporate social irresponsibility attributions with respect to the National Football League (NFL). In the modern professional game, players are massive. It is not uncommon for players in certain positions to be over 190 cm tall and to weigh well over 135 kg. American football is a game of collisions, and predictably the collisions among players who are large and who are moving fast can be quite severe, protective equipment notwithstanding. The NFL's potential irresponsibility with respect to the head injuries issue is a grey area—it is being actively interpreted and contested—and the stakes are high. The NFL enjoys considerable public support and government cooperation that allow the league to operate in a manner that can be likened to a monopoly and earns on the order of \$9 billion in revenues per year for itself and its teams. Strong social irresponsibility attributions could erode public support, perhaps diminishing the TV viewership of games that is so lucrative to the League and lessening the US public's appetite for funding new NFL stadiums. Government cooperation could also be eroded, perhaps resulting in efforts to expose the business to increased competitive forces.

Head injuries in American-style football are not a new issue, of course. In fact, a quick search of historical press reports shows that football-related concussions have been associated with deaths and debilitating injuries since the late 1800s. However, in recent years attributions for that problem have increasingly pointed to the NFL, an organization that has existed since 1920 (since 1922 under its current name). A number of factors influence attributions that may or may not hold the NFL as socially irresponsible.

One important factor is the recent increase in both scientific knowledge and anecdotal evidence that have linked repeated concussions—especially repeated concussions without adequate healing time in between—to possible serious long-term health problems, including permanent brain damage, dementia and clinical depression. Whereas head injuries formerly seemed to be an ongoing but relatively uncommon part of the game, scientific and media attention have substantially increased their salience to even the casual observer. As evidence of possible long-term health consequences mounts, the gravity of public discourse about head injuries in football escalates. Observers pay heightened attention to the negative impact of the game on players, focusing on what may be preventable human suffering, and

search for responsible parties to blame. Processes of attribution are triggered when observers make a tentative connection between an organization and an undesirable effect, and the NFL, because it is the most prominent and most lucrative purveyor of the game of professional American-style football, becomes a natural target for attributions.

In the process of assessing the NFL's potential irresponsibility, observers come to conclusions about whether the organization actually caused the problem. Towards that end, observers might consider that, on the one hand, the NFL runs the game in which players get injured, but, on the other hand, players typically have had many years of experience in football prior to the NFL—often in college, high school and youth football—and may have sustained head injuries at various points in their lives. Assessments of causality can be undermined if observers focus on potential alternative explanations for the problem.

And, even when observers do see a strong causal link between the NFL and a negative health impact on players, social irresponsibility attributions further require that the NFL be seen as morally responsible. This means that observers come to the conclusion that the NFL willfully exposed players to danger without strong justification and in spite of having options for reducing that danger. Social irresponsibility attributions could therefore be strengthened if evidence emerges that the NFL was well aware of negative health effects to players, but attempted to downplay or cover them up. Then again, social irresponsibility attributions could be weakened if observers believe that the NFL is proactively responding to the head injury problem, for example, by improving protective equipment or instituting rule changes that discourage certain types of helmet-to-helmet forcible contact. Moreover, observers may see the NFL as less morally responsible if they are convinced that measures to substantially enhance player safety would necessarily degrade the game in unacceptable ways.

Importantly, the organization's existing reputation can easily influence observer assessments of moral responsibility. The NFL has been associated with a number of controversies over the years involving its handling of player issues, including its aggressive approach to labour negotiations, its control (or lack of control) over the use of performance-enhancing drugs, and the purportedly hostile environment for homosexual players. Depending upon how observers have made sense of the NFL's behaviours and outcomes in past controversies, observers may be predisposed to viewing the NFL as more or less willfully irresponsible in current controversies.

Another important factor that influences corporate social irresponsibility attributions is the degree to which observers believe the affected parties are partly or wholly responsible for their own fate. NFL players might very well be seen as voluntarily making the tradeoff between possible health risks and high rewards including fame and fortune. Or they might instead be seen as victimized and callously used by

a system in which their ability to foresee negative health effects and their power to prevent those effects is severely restricted. To the extent that players are seen as voluntarily and knowingly engaging in the risk-reward tradeoff, the less likely it is that the NFL will be seen as culpable.

The process of attribution is also affected by the degree to which the observer socially identifies with the affected party of the organization. Here, an observer feels an overlap between self-identity and the other's identity—a greater sense of oneness with the other. If an observer socially identifies strongly with NFL players, he or she might find the issue of head injuries highly salient and even personally threatening, and consequently search more intensively for causality and responsibility. The popularity of replica jerseys may be an indicator of the high degree to which NFL fans identify with players. However, it is also possible that the typical NFL observer has a hard time truly identifying with professional athletes. Perhaps the typical ardent fan identifies more with the NFL as an organization than with its players. If so, attributions are likely to be favourable to the NFL, meaning that observers see the head injuries issue as less serious and the players as more complicit in their fate. Observers with strong social identification with the NFL are likely to be sceptical that it has engaged in behaviours contrary to their expectations, and are likely to be more accepting of accounts and explanations from the NFL and its advocates that contend innocence or justify the NFL's association with the negative health effects of the game.

Finally, social irresponsibility attributions made by an individual observer will be heavily influenced by the ways the issue is being framed by others in the observer's environment. For example, observers may attend to how their friends are talking about the head injury issue, how it is being discussed in the media and by politicians, how other major sports organizations, such as the National Collegiate Athletic Association, are discussing and addressing the issue, and how the NFL itself is framing the issue. By emphasizing, deemphasizing, and perhaps distorting different aspects of the head injury issue, other parties can affect the inferences and judgments that observers make about the NFL's potential social irresponsibility. Depending upon how the issue is framed by others, head injuries may appear to observers as more or less problematic, the players may appear as more or less complicit in the problem, and the NFL may appear as more or less causal and morally responsible.

The distinction between perceptions of corporate social irresponsibility and a presumed underlying reality of irresponsibility is crucial, since reputational penalties do not occur because an organization has actually engaged in irresponsible behaviour, but because it is perceived to have done so. The processes of attribution therefore can help to explain why some instances of corporate behaviour that actually create harmful social side effects may not result in sanctions for the organization, while other instances of corporate behaviour that are objectively less damaging may inspire strong negative reactions against the organization. To

more fully understand the relationship between corporate behaviour and sanctioning responses from the corporation's environment, we must understand how rational analysis, human biases and social influences combine to affect how observers pay attention and how they interpret and infer blame for negative outcomes. This certainly calls for a multi-level research agenda, because corporate social irresponsibility attributions necessarily entail cognitive processes that are inexorably intertwined with stimuli from the observer's environment, especially in the form of frames that are produced and contested socially.

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Negative consequences of good reputation and positive outcomes of negative events

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Organizational researchers have been increasingly interested in the role of reputation for the financial success and survival of organizations (Fombrun and Shanley, 1990; Rao, 1994; Rindova *et al.*, 2006; Deephouse and Suchman, 2008). Information intermediaries, such as news media and rankings agencies, are among the most influential sources that affect the overall social approval, or reputation, of an organization. High reputation, in turn, affects organizational success and survival (Deephouse, 2000; Rindova *et al.*, 2006; Pfarrer *et al.*, 2010). Ranking highly in such lists as the *Fortune 500* or *America's Most Admired Companies* and being covered positively in the news helps organizations gain high reputation among stakeholders, which becomes a valuable asset and a source of competitive advantage (Fombrun, 1996; Rindova and Fombrun, 1999).

Organizational reputation can serve as a particularly valuable asset after negative events, or incidents that place an organization's stakeholders at risk and violate stakeholders' expectations of societal norms and general standards of conduct (Pfarrer *et al.*, 2008). Events such as boycotts, stock market crashes, product recalls and industrial accidents lower social approval of organizations (Fombrun, 1996; King, 2008; Pfarrer *et al.*, 2008; Mishina *et al.*, 2010; Zavyalova *et al.*, 2012) and have a

negative effect on stakeholders' willingness to dedicate financial resources to and transact with the organization (Zyglidopoulos, 2001; Schnietz and Epstein, 2005; Rhee and Haunschild, 2006; King and Soule, 2007). While organizations invest time and financial resources to build positive reputation, organizational researchers have only started to investigate whether such investments are helpful in light of negative events.

In this essay, I propose that a fruitful area for research on the role of organizational reputation following negative events is the reasons for variance in *stakeholders' interpretations* of information about organizations. Specifically, drawing from research in psychology and social psychology, I focus on three contingencies that, after some investigation, may lead to counter intuitive conclusions: Having a high reputation may result in negative consequences and negative events can have positive outcomes. These contingencies are (i) the role of stakeholders' attention and expectations, (ii) the role of wrongdoing by organizational competitors and (iii) the role of stakeholders' identification with an organization. I elaborate on each contingency below.

1. Stakeholder attention and expectations

Having a high reputation may lead to negative organizational outcomes. This can happen for two reasons. First, negative events in highly reputable organizations are more likely to be publicized in the media and attract stakeholder attention. As organizational and mass communication research has shown, a primary reason some events are covered in the news is the involvement of a prominent person, nation or organization in the story. One of the characteristics of highly reputable organizations is their prominence among various stakeholder groups (Pfarrer *et al.*, 2010), thus negative events in such organizations will be viewed as newsworthy. Events that involve so-called 'elites' are compelling because prominent people and organizations are well-recognized and thus appeal to a larger audience (Galtung and Ruge, 1965; Rindova *et al.*, 2005). The wider appeal increases the amount of attention audiences will pay to the news. Consequently, increased stakeholder attention to the news about negative events in highly reputable organizations can decrease the levels of social approval of the organization (Zavyalova *et al.*, 2012).

The second reason having a high reputation may lead to negative organizational outcomes is that negative events in highly reputable organizations are more likely to violate social expectations than similar events in organizations without high reputation. Highly reputable organizations are known for meeting and exceeding stakeholders' expectations; hence, negative events in such organizations will be viewed as unexpected (Pfarrer *et al.*, 2008). For instance, recalls by Toyota, a manufacturer known for vehicle reliability, are more unexpected than similar recalls by Ford, which may result in higher levels of negative surprise among stakeholders and

transactional losses for Toyota. One study found that automakers with high reputation suffered greater market penalties following severe product recalls. The authors argue that high reputation might be a liability as it increases social expectations about appropriate conduct by highly reputable organizations (Rhee and Haunschild, 2006). Thus, because stakeholders are likely to interpret negative events in highly reputable organizations as violations of their expectations, investing in high reputation may lead to unexpected negative consequences.

2. Wrongdoing by competitors

Wrongdoing by competitors can benefit organizations involved in negative events. As my coauthors and I argue in a recent article on toy recalls in the US, when a single organization engages in wrongdoing, this action is salient because it is novel and unusual within the industry (Zavyalova *et al.*, 2012). In such a case, the organization is more likely to attract a disproportionate share of negative publicity and suffer from reputational penalties. However, if several other organizations engage in similar negative events, any specific event is no longer novel and stakeholders will pay less attention to any one organization in particular (see also Ahmadjian and Robertson, 2001; Pfarrer *et al.*, 2008). Thus, during times of wrongdoing within an industry, the focal organization may experience a safety-in-numbers effect: The direct negative effect of wrongdoing on an organization's reputation is smaller when the organizations competitors are engaged in wrongdoing.

In light of competitors' wrongdoing, innocent organizations can take the opportunity to distance themselves from the culprits and signal that they are not like their guilty competitors. As we find in the US toy industry, publicity announcing actions that highlight positive characteristics of an organization—such as company name changes, celebrity endorsements, charitable donations, promotions and sweepstakes, acts of corporate citizenship (e.g. sponsoring children's talent shows), and announcements of company awards, helps organizations gain positive publicity (Zavyalova *et al.*, 2012). Thus, because stakeholder interpretations of the information about a focal organization are not formed in a vacuum, but rather depend on the actions of other organizations in the industry, managers can use competitors' wrongdoing to soften negative publicity or use ceremonial actions to deflect the attention of the public from the negative events.

3. Organizational identification

Lastly, negative events in high reputation organizations can lead to positive outcomes. This is because different stakeholders interpret the same information about negative events in organizations in different ways. Specifically, the level of stakeholder identification with an organization can have a profound effect on their interpretations. Individuals who identify closely with an organization

perceive that the future and well-being of the organization are connected to their own identities (Ashforth and Mael, 1989). This connection is even stronger for highly reputable organizations, because it may serve as a source of increased self-esteem and vicarious self-enhancement (Bartel, 2001). Indeed, prior research has found that when an organization is faced with a negative event, individuals who closely identify with the organization attempt to justify the negative event, reframe the negative information about the organization, and support and defend the organization in order to protect their personal identities (Elsbach and Kramer, 1996; Nag *et al.*, 2007; Kovoov-Misra, 2009).

For instance, in my dissertation, I argue theoretically and find empirical evidence that stakeholder reactions to negative events depend on the level of organizational reputation as well as organizational identification. I study these dynamics on a sample of on-campus murders and separately on a sample of NCAA rule violations in US colleges and universities in 2001 and 2009. The results indicate that in highly ranked universities non-alumni (stakeholders with low levels of organizational identification) decrease donations following on campus murders or NCAA rule violations, while alumni (stakeholders with high levels of organizational identification) increase their donations to highly ranked universities. Thus, when an organization has a lot of stakeholders with high levels of organizational identification, it may achieve positive outcomes after negative events.

In conclusion, research on organizational reputation is still nascent and provides a lot of opportunities to investigate unexplored questions. While somewhat counter-intuitive and, perhaps, controversial, the arguments I raise in this paper are not made to suggest that organizations should not invest in building positive reputation, that they should stay away from the media spotlight and keep stakeholder expectations at low levels, or that organizations should engage in negative events to increase support from stakeholders with high levels of identification. Rather, I present these arguments to illustrate issues in the area of organizational reputation that remain unexplored and, in my opinion, need further investigation. My goal here was to emphasize the role of stakeholders' interpretations as a micro-foundation of an organizational reputation. I believe that by drawing from research in psychology and social psychology future studies can better our understanding of the role of organizational reputation during negative events and the effectiveness of strategies companies can take to rebuild, preserve, and repair their reputations among different stakeholders.

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The companies we keep: from legitimacy to reputation in retail investment

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Nevertheless a certain class of dishonesty, dishonesty magnificent in its proportions, and climbing into high places, has become at the same time so rampant and so splendid that there seems to be reason for fearing that men and women will be taught to feel that dishonesty, if it can become splendid, will cease to be abominable. Trollope ([1883] 1999, p. 354)

These reflections by novelist Anthony Trollope were catalysed by the reinstatement in English law of the joint-stock firm—a form of organization that fell into disgrace after the South Sea Company committed history's first known corporate fraud (Harrington, 2013). Trollope feared that the wealth generated by the new crop of limited liability firms would damage the foundations of social life by distorting norms of honor and honesty, just as the South Sea Company had done a century before. While such concerns may seem antiquated, we find them echoed in the work of many contemporary scholars (Partnoy, 2009; see also Macey, 2013).

Surprisingly, few studies have examined public response to unethical or illegal behaviour by firms, despite some research on institutional investors, organized protest groups or shareholder activists (McDonnell and King, 2013). Although a robust research shows that corporations invest heavily in impression management—crafting narratives and ‘information subsidies’ (Rindova *et al.*, 2006) to establish an identity (Zavalyova *et al.*, 2012)—the relevant audiences for these messages have generally been construed by scholars as *other organizations*, obscuring the micro-foundations of market activity.

This essay will address the knowledge gap by drawing on evidence from a long-term field study of retail investors—a group known colloquially as ‘the investing public’ (Harrington, 2008, 2009, 2012a). Based on their responses to firms’ misconduct before and after the corporate fraud scandals of the twentieth century, this paper will extend current theoretical models by combining the micro level of analysis with considerations of historical context. The latter is particularly important in explaining how the evaluative standards applied to corporations change over time.

Studying retail investors at a particularly tumultuous period allows us to examine the neglected micro level of analysis, but in a way that brings history back in. Although not finance professionals, retail investors are nonetheless bombarded with information about corporate behaviour and identity from the news and advertising, making them an ideal population for a study of public responses to corporate malfeasance. Moreover, they represent a sizeable portion of both economy and society: in the USA, over 51% of adults own stocks, amounting to \$5.5 trillion in corporate equities or a quarter of total market capitalization (Harrington, 2012a, b). These numbers have held steady for over a decade, through numerous corporate fraud scandals, as well as the dot.com bubble, the housing crash and the 2008 financial crisis (Bucks *et al.*, 2009).

This paper is based on a data set that includes observations from over 100 retail investors at two points in time: the height of the bull market, spanning 1998 to 1999; and then again in 2004, post-Enron and WorldCom. The evidence shows that when corporate misconduct appears rare or atypical, investment choices are based not only a stock's profit potential but on its ability to enhance the owner's identity by

association. Under these conditions, retail investors also avoid stocks that might reflect badly on them by association, due to illegal or unethical behaviour by issuing firms (Harrington, 2008).

But when corporate misconduct becomes so widespread as to appear ‘normal’—the state of affairs to which Trollope alluded—public response undergoes a dramatic shift. When investors believe they have no choice apart from investing in firms engaged in illegal or unethical activity, they adapt by changing their standards of evaluation—a move that simultaneously changes their self-evaluations. They move from a position of judgment over corporations to one of knowing complicity with misconduct.

To account for this shift, this paper will draw on the conceptual distinction between legitimacy and reputation (Deephouse and Carter, 2005). While reputation involves an assessment of relative standing vis-à-vis peers, legitimacy implies comparison with a broader social standard (Suchman, 1995). Thus, an entity’s reputation depends on what its peers are doing, but its legitimacy derives from adherence to social norms and expectations. This paper will extend this discussion using concepts from social psychology—particularly power and social identity—and suggest some conditions under which legitimacy or reputation take precedence in evaluations of firms. A key finding is that in the face of widespread corporate misconduct, what changes is not corporate behaviour, but the social meaning of that behaviour.

1. Identity investing

In the wake of the seemingly endless string of corporate and institutional frauds, it may be difficult to recall the optimism surrounding the stock market in the 1990s. This decade transformed investing from an elite activity to one that included more than half of the adult population of the USA (Harrington, 2008). As ‘Wall Street became Main Street’, there seemed to be ‘limitless opportunity’ (Krugman, 1998), particularly for the new retail investors.

With their confidence in the integrity of the market intact, investors picked and chose stocks based on social legitimacy. This led to rapid growth in socially responsible mutual funds: investment vehicles whose component stocks are selected based on religious or secular notions of ‘desirable, proper, or appropriate’ (Suchman, 1995, p. 574) activity. Retail investors tripled the capitalization of these funds within 2 years—from \$529 billion invested in 1997 to \$1.5 trillion in 1999 (Geczy *et al.*, 2003). These preferences of ‘the investing public’ defied the conventional wisdom in professional finance, which was summed up by one investment manager as ‘you can’t be in stocks if you’re going to ask moral questions’ (Hakim, 2001, p. 26). As this comment suggests, within the small world of institutional finance—the environment in which most studies of the impact of corporate

identity and misconduct have been situated—the *social legitimacy of corporate activity has been considered irrelevant*.

For retail investors, however, legitimacy was central to their decisions—as long as they believed that any corporate misconduct was a case of a few ‘bad apples’ rather than a pervasive problem. Their faith in the integrity of most publicly traded corporations was manifested in selectivity about the kinds of firms with which they wanted to be associated. The process of deciding among the thousands of stocks available started with a financial analysis, screening for sectors and firms most likely to be profitable (Harrington, 2008). That strategy narrowed the field to a handful of possibilities, but was rarely sufficient to provide a decisive solution.

Thus, the initial screening was followed by a second process, which I termed ‘identity investing’ (Harrington, 2008). This involved assessing the match between a firm’s identity and the investor’s. Investing is social (Shiller, 1993) in that people talk with their friends, family and neighbours about their portfolios (Katona, 1975). But this *inter*-personal character of investing is matched by an *intra*-personal aspect: retail investors seek congruence between their stock purchases and their social identities. As we know from social identity theory, individuals seek not only to enhance their sense of self, but also to avoid the cognitive dissonance created by activities that conflict with their desired identities (Hogg and Terry, 2000; McKimmie *et al.*, 2003).

While none of the individuals I studied articulated a formal policy about ‘socially-responsible investing’, they wove identity considerations into all of their stock selections. For example, when I asked one woman why she and her friends did not invest in tobacco or petroleum firms, she answered, ‘It’s just the kind of people they are. They’re not interested in supporting those companies’. This identification process applied to the whole spectrum of firms. Thus, I observed individuals analysing Home Depot—a firm involved in the uncontroversial building supply industry—decide against investing in the highly profitable company because they did not wish to be associated with its labour practices:

Leonard: Some women employees have filed a sexual discrimination suit against Home Depot.

Sid: Home Depot won’t hire women; their ethic is to have staff who are expert in using the products themselves, and they apparently don’t think women qualify.

Leonard: The firm settled out of court.

Grant: Women don’t shop there.

Troy: The women employees run the cash registers or work in the design section.

These investors rejected Home Depot based on their assessment of ‘corporate citizenship’—the legitimacy of the firm’s activities vis-à-vis broader social norms. This was a common theme in the data: even if a firm did nothing blatantly illegal, any ethically distasteful or ambiguously legal activity—‘alegal’, as Partnoy (2009) puts it—was sufficient grounds for negative evaluation by the investing public in the 1990s.

These decisions were not necessarily high-minded or moral. Typically, they were guided by identity considerations: the kinds of companies these individuals wished to keep. For instance, the same men who rejected Home Depot also refused to buy stock in La-Z-Boy—a maker of reclining chairs—because of the firm’s image as a brand for the working class. This decision-making pattern was repeated with other stocks and other investors, suggesting that their assessments of firms’ legitimacy were not only connected to general social norms, but more specific notions of appropriateness for *the kind of people they were*, or aspired to be (Harrington, 2008). Some 5 years later, however, this legitimacy-oriented decision process was supplanted by one that foregrounded reputation.

2. Unindicted co-conspirators

If, as Deephouse and Carter (2005); (see also Suchman, 1995) have written, legitimacy is assessed relative to broader social norms, what happens when mass violations of social norms take place? When it becomes obvious that misconduct is systemic, rather than the work of a few ‘bad apples?’ One consequence is a radical restructuring of the terms on which firms are evaluated. Following the accounting fraud scandals of the early twenty-first century, if retail investors had continued to screen firms based on legitimacy, they would have found that very few made the cut. Some corporations, to be sure, continued to be aligned with social norms, but were not necessarily profitable enough to provide for retirement savings and investors’ other major financial goals (Harrington, 2012a, b). Lacking the power to transform the firms themselves, retail investors instead changed their frame of reference. Specifically, they shifted from assessing firms in terms of a broad standard of social appropriateness or legitimacy to viewing them in terms of reputation relative to their corporate peers.

Owing to their economic dependence on the stock market (Harrington, 2008), evidence of widespread corporate malfeasance did *not* lead these investors to withdraw from the market. Some of them simply did nothing, ceasing to buy *or* sell stocks. As one woman in my study put it, ‘I have no idea what to do now that we know you can’t trust anything firms tell you’. For the others, the investment task

shifted from picking the best stock (the one offering the greatest profit and identity enhancement) to one of picking the least-bad apples from a rotten barrel.

In fact by 2004, participants who had not previously expressed any reservations about the integrity of corporate behaviour began claiming that they had known all along that corporate fraud was commonplace. For example, one woman in my study said ‘My experience in the work world taught me that business people cheat all the time, so the scandals didn’t come as a surprise’. Another individual claimed

I knew there was cheating going on in the whole market . . . And the scandals haven’t damaged my trust in the system because I never trusted it to begin with. So some people got special deals from mutual fund managers—so what? I work at [a major defense contractor]: we see special deals all the time!

In other words: everyone does it. As the sociological literature on accounts (Orbuch, 1997) indicates, shifting the standard of evaluation from absolute to relative comparisons is a standard mode of damage control. What is surprising here is to find retail investors rationalizing corporate behaviour in this way. Why would investors make excuses for firms?

Power can motivate individuals to shift their standards of evaluation. Abandonment of the legitimacy standard for assessing corporate conduct can be interpreted as symptomatic of the power imbalance between corporations and retail investors (Harrington, 2013). These individuals wielded genuine power through the hundreds of millions of dollars they poured into the market every month. This economic clout translated into the explosive growth of socially responsible investment funds, which continues even in the aftermath of the 2008 financial crisis (Cortez *et al.*, 2012). But when faced with an array of choices that *all* looked bad from an ethical or social identity point of view, retail investors lacked the defining resource of situational power—the ability to walk away (French and Raven, 1959; see also Hirschman, 1970). For so many of these individuals, the weakened social safety net in the USA left them with no alternative but to own stocks and hope for the best. As several in the study put it, using identical wording, ‘Where else are we going to put our money? In the mattress?’ One woman summed up this perspective by remarking, ‘I can’t afford to leave [the market]. . . I have to make my money back’. Such observations suggest the following empirically testable proposition:

Proposition 1: If X is dependent upon Y, then evidence of misconduct by Y will lead X to shift from legitimacy to reputation as an evaluative standard.

Ongoing engagement with a system known to be corrupt is likely to have consequences for the identities of individuals involved. Since avoidance of cognitive dissonance is a major force in social identity processes (McKimmie *et al.*, 2003),

continued participation in a stock market tainted by corporate malfeasance created a problem for investors: by associating themselves with cheaters, they were threatening their own identities as good people. This necessitated a shift in the alignment of identities between retail investors and firms. Where once they could be choosy about the kinds of companies they kept, they now had to take what they could get and revise their self-evaluations accordingly.

Through retrospective sense-making and revisionist history, participants in this study altered their standards of self-evaluation from one of personal honour or integrity to one of street-wise intelligence. Thus, one man I interviewed in 2004 said of his engagement with the stock market in the 1990s, 'I knew it was a sham back then. I was just riding it as long as I could'. Similarly, a woman in the study said, 'We sort of knew the books were cooked; I kind of saw it coming'. Though they could no longer credibly claim to be honest investors, they could at least claim to be smart. Given that 'there is no crime in the cynical American calendar more humiliating than to be a sucker' (Lerner, 1949, p. 300), it is perhaps not surprising to find retail investors—unable to exit the stock market, but still trying to maintain some congruence in their social identities—describing themselves as 'greedy' and as 'money whores'. These identities made them accomplices, rather than victims.

Ultimately, the corporate fraud scandals of the early twenty-first century catalysed *two* shifts in the standards of evaluation: one for firms, and the other for investors. The anecdotes extracted from my study suggest that evaluators—whether investors, consumers or other stakeholders—see *themselves* differently when they move from a legitimacy standard to a reputational standard in their assessment of firms. Linking the work of Deephouse and Carter (2005) to the literature on identity in social psychology, we can derive the following proposition:

Proposition 2: If X alters its evaluation of Y from the legitimacy standard to the reputation standard, a corresponding shift will occur in X's self-evaluation.

There is as yet insufficient evidence to specify the direction of this shift in self-evaluation. While it seems likely—based on the data presented here—that the shift would be negative, this is a question that future research should explore in other contexts.

Finally, this essay suggests the need for research that takes account of broad patterns in corporate activity. Though most research in this vein has focused on single organizations or incidents (e.g. McNamara *et al.*, 2002), the evidence presented here—along with the historical record (Harrington, 2013)—indicates that public response to corporate misconduct is strongly influenced by historical context. By shaping the standards against which they are evaluated, this context affects firms' survival in the marketplace; Deephouse and Carter (2005) implied as much

about the commercial banks they studied. This suggests a final proposition for empirical testing

Proposition 3: When a large group of organizations lose legitimacy, reputation increases in significance so that being less well-regarded than others can threaten a firm's continued existence.

3. Conclusions

This paper extends the theoretical distinction between legitimacy and reputation by linking it to social psychological theories of power and identity. Consistent with recent work on the overall decline of sanctions for corporate misconduct (Macey, 2013), the evidence from retail investors suggests that even when firms lose legitimacy, they experience few financial consequences for that loss—*as long as they maintain a reputation no worse than their peers*. Meaningful penalties for corporate misconduct, the kind likely to evoke behavioural change, can only be meted out by other organizations, specifically ‘those that exercise coercive power or mobilize other social actors’ (Deephouse and Carter, 2005, p. 351). Lacking that power, retail investors changed what they *could* control: their evaluative standards for firms, and their own social identities.

For the investing public, the weight of corporate reputation relative to legitimacy has probably increased since 2004, when the last of the data discussed in this paper were gathered. The global financial crisis of 2008 certainly did nothing to restore public faith in firms. If anything, the absence of meaningful sanctions for illegal or illegitimate behaviour (Macey, 2013) has only solidified the impression that corporate misconduct is the ‘new normal’. Or, as Trollope put it, ‘dishonesty magnificent in its proportions, and climbing into high places’ seems to have made assessment of firms’ legitimacy vis-à-vis absolute standards of social acceptability increasingly irrelevant. What remains are considerations of reputation—a relativism that would have horrified Trollope, but is perhaps better suited to an era in which the pragmatics of the market have colonized the life-world (Habermas, 1985).

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Six shades of grey: a legal perspective on reputation

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Law and reputation are closely connected, as are the grey areas related to and created by each. Law attempts to regulate grey areas by defining norms, but also creates new grey areas and can implicitly sanction bad behaviours. Legal rules affect reputation, because stakeholders and the public pay attention to whether behaviour is illegal or not. Conversely, reputation affects law. Judges and regulators view conduct in

context, not in the abstract, and context includes reputation. Private actors benefit from expending resources to develop reputations that minimize legal and regulatory costs and maximize private value. Such actions can create new grey areas of law, which in turn create new areas of grey behaviour and so on.

In this essay, I draw on some of my previous work to highlight six ways in which the relationship between law and reputation is shaded grey. Although legal rules and reputation are sometimes seen as black–white and clarity appears to be prized, in fact the opposite is often true: a closer examination of law and reputation reveals that the grey areas are more prevalent and interesting than many commentators realize; moreover, uncertainty, rather than clarity, can generate superior policy results. I will refer to these six areas as: optimality of bad behaviour, a legality, *ex ante* specification of standards, regulatory arbitrage, *ex post* assessment and regulatory licences. I reference some of my writings on these topics in the bibliography and at various points in this essay. My most general attempt to cover these areas is Partnoy (2003).

First, consider this perhaps offensive question: what is the optimal amount of illegal behaviour for one's reputation? From a sociological perspective, even asking the question seems immoral, and perhaps even counter to establishing a good reputation. One might imagine that the sort of person or corporation that would contemplate optimizing the amount of illegal behaviour would be the sort of individual or corporation that necessarily would have a bad reputation. Yet if reputation is viewed as a capital asset, then—like other assets—it is scarce, costly, and, most important, expendable. Both individuals and corporations should want to obtain value from any scarce, costly, expendable asset. Why buy a machine unless you are going to use it? Why buy inputs to goods unless you are planning to deplete them? The same analysis holds for reputation.

Once a person or corporation has a stock of reputational capital, she or it has an incentive to use that capital, either by charging more money, by shirking, by defrauding others or by engaging in illegal behaviour. If reputation is regarded as a sacred unalloyed good, then she might find depleting it to be anathema. But if reputation is simply an asset, illegal behaviour becomes explicable, and even rational. Consider an orthopaedic surgeon with a stellar reputation. What should that person do? She might decide to preserve or even attempt to improve on that reputation by continuing to behave as she has in the past, complying with legal rules and ethical principles. Alternatively, she might decide to monetize a portion of that reputational capital by overcharging patients and performing unnecessary procedures. Grey areas arise when one set of legal rules suggests a norm of profit maximization and another set of legal rules suggests that some profit-maximizing behaviour is illegal.

Second, and relatedly, behaviour can fall into the gaps between legality and illegality; indeed much behaviour in complex highly regulated markets can be

described as ‘alegal’, a term I first used in Partnoy (2003). If a large body of regulation has developed to govern a particular class of conduct, participants frequently infer that if conduct is not specifically prohibited in regulation, then that conduct falls into an unregulated grey area: it is not clearly illegal, but it is not clearly legal either. Many of Enron’s complex financial transactions fell into this category, and Enron’s managers drew inferences that their conduct was permissibly alegal, though perhaps dubious. Similar conclusions hold for the super-senior credit default swaps based on synthetic collateralized debt obligations that were at the core of the recent financial crisis (Partnoy and Skeel, 2007).

Alegality can become part of a firm’s or group’s culture. Moreover, alegality can arise along with the influence of market participants on legal rules. Public choice theory suggests that some powerful private institutions will outmanoeuvre and outspend diffuse public constituents, and end up ‘capturing’ public regulatory interests. Many of the most spectacular collapses in business—both Enron and the banks in the financial crisis—have involved large institutions that lobbied to preserve the alegal status of their business, and yet ultimately make spectacular errors and found those businesses unsustainable.

Third, grey areas can arise from the *ex ante* specification of legal rules (Partnoy, 2005). In fact, these types of grey areas have expanded as the modern regulatory state has grown and regulation has shifted from *ex post* specification of standards to *ex ante* specification of rules. Imagine if instead of broadly prohibiting murder, society instead specifically enumerated types of murder that were deemed illegal: thou shalt not murder with a knife, thou shalt not murder with a gun, thou shalt not murder with a rope and so on. In such an *ex ante* rules-based system, what is a person to think about the rightness or wrongness of murdering with a pillow? Wendell Holmes told the story of a judge deciding a contract dispute who ruled against an aggrieved party because he had looked through the relevant set of legal rules and could not find anything addressing churns.

Modern markets are replete with financial innovation analogues to the murder hypothetical or the churns story: *ex ante* tax regulations provide that corporate dividends on equity securities are subject to double taxation so corporations issue hybrid securities whose risk and return characteristics resemble those of equity securities, but are not subject to double taxation. *Ex ante* margin requirements and restrictions on short selling lead market participants to engage in grey area derivatives transactions that are economically similar to short selling, but which do not formally involve that practice. *Ex ante* rules that require hedge fund activists to disclose equity positions of greater than 5% lead those funds either to buy only 4.99% of a company’s stock or to transact large equity derivatives positions instead of buying stock. And so on.

Fourth, private market participants can generate grey areas through their reaction to legal rules, particularly through sophisticated forms of regulatory avoidance

strategies known collectively as ‘regulatory arbitrage’ (Partnoy, 1997). The idea of arbitrage is for a market participant to buy low and simultaneously sell high in order to make a riskless profit. Regulatory arbitrage is a version of riskless profit that arises from the use of a transaction that is not subject to regulatory costs in place of an economically equivalent transaction that is subject to regulatory costs. For example, a bank might enter into an interest rate swap instead of the leveraged purchase of a fixed income instrument, in part because the two legs of the swap are not disclosed on the balance sheet as an asset and a liability. A corporation might finance an acquisition using a hybrid debt structure because it avoids taxes. A pension fund that is prohibited from trading in foreign exchange might purchase a structured note issued by a highly rated institution with returns linked to foreign exchange rates.

These categories of regulatory arbitrage—avoiding accounting disclosure, reducing taxes or skirting investment restrictions—create another form of grey areas, where regulatory treatment can be unclear. Are these transactions illegal? Some general anti-abuse principles govern some categories of financial transactions, particularly related to tax. But there has been only limited enforcement of those principles, and for other areas, such as disclosure or violations of investment restrictions, it is unclear whether anti-abuse principles even apply.

A fifth type of the grey area is created when regulators engage in *ex post* assessment of behaviour (Partnoy, 2002). This issue poses challenges that are opposite to those created by *ex ante* specification of detailed rules. If regulators simply state a general principle and then commit to enforce it after the fact—as they might with a ‘suitability’ requirement in the sales of securities—then market participants do not know with certainty when they have crossed the line into illegal behaviour. The sale of one financial instrument to a relatively unsophisticated investor might be deemed ‘suitable’, whereas the sale of another, perhaps equally complex, instrument to another, perhaps even less sophisticated, investor might be deemed ‘unsuitable.’ Market participants complain vociferously about the creation of such grey areas.

And yet those grey areas might be precisely what regulators need in order to implement economically efficient and fair policies. Uncertain application of *ex post* principles can be an effective deterrent to bad behaviour. Moreover, if private market participants have a competitive advantage over regulators in understanding which behaviour is ‘bad’, then a rule subjecting those participants to potential liability under a broad principle will lead them to impound their own information and judgment about what is ‘bad’ in their conduct. Indeed, to the extent reputation-related mechanisms affect private behaviour, they operate in precisely this way: parties think about the potential future consequences of conduct on their stock of reputational capital. By adopting a regime of general principles, regulators can attempt to encourage this type of forward thinking. Of course, there is the risk

that the specification of general principles might prevent some private parties from being able to pledge that they would act in accord with the general principles even in the absence of a legal mandate. Nevertheless, although regulators are not likely to have a comparative advantage in specifying conduct *ex ante*, adjudicators might have an advantage in assessing conduct *ex post*.

Finally, law and reputation can interact in deleterious, grey ways when legal rules delegate 'regulatory licences' to private gatekeepers and thereby remove reputational incentives and consequences for those gatekeepers (see Partnoy, 1999, 2006). Imagine that particular private food safety assessors have come to acquire reputational capital and are relied on for their certification of food products as being safe. Assume this evolution occurred in the absence of legal rules. Then imagine that the legislature adopts a legal rule requiring certification of food products by these assessors (who, after all, are the proven experts in the field). Now, the assessors' incentives have changed. Whereas they previously wanted to certify products accurately and in the most efficient and fair way possible, now they are subject to the temptations of food producers who want to buy a key that unlocks the food markets through certification. The 'regulatory licence' is the right to be in compliance with the new legal rule.

Regulatory licences create grey areas by converting private gatekeepers into quasi-public natural oligopolists. Did the credit rating agencies that rate bonds survive and prosper based on their ability to certify the quality of those bonds? Once hundreds of legal rules were promulgated that depended substantively on those agencies' ratings, as happened when such rules were first established during the 1970s, the dynamic changed. The credit rating agencies shifted from quality certifiers to sellers of regulatory licences, keys that unlocked the financial markets. As a result, the quality of ratings became greyer: should one continue to trust an 'AAA' rating? The widespread collapse of highly rated products during the financial crisis suggests that the answer was, and perhaps still is, no.

Overall, the grey areas that arise from the complex interaction of law and reputation are not just important to policy decisions. They raise deep ethical questions. Is reputation merely a capital asset? Is law a costly norm that can be avoided under certain conditions? The implications of the questions about grey areas are troubling: how can social judgments about reputation continue to have moral force when private parties commonly engage in instrumental calculations to take advantage of and exploit the grey areas that arise because of law?

The idea of 'professionalism' is that certain participants in society should elevate ethical principles and standards of conduct over profit, and that a 'professional' reputation is its own good, for the benefit of both individuals and society overall. The modern emphasis on profit and profit maximization is in tension with the notions of 'professionalism'. As the grey areas enumerated above expand, so do these tensions.

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Reputational dynamics of private regulation

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Public regulation has undergone a gradual decline in the global economy. As public regulation has waned, many scholars, activists and policy reformers posit that private regulation is an effective replacement. Rather than ask government to regulate firm behaviour, private regulation implies that normal citizens, often in the form of activist groups or NGOs, incentivize or punish firms that fail to live up to socially responsible standards (Bartley, 2007; Vogel, 2008). In private regulation, no legal means exist to enforce compliance; instead, reputation is a key mechanism in any push to influence firm behaviour (Baron and Diermeier, 2007). Proponents realize that to make private regulation effective, firms must be motivated to care about their reputations.

Private regulation uses reputation as both a carrot and a stick. The carrot is (at least theoretically) that as firms adopt higher standards of socially responsible behaviour (e.g. agreeing to stop using sweatshop labour to produce sneakers), they

will be rewarded with a distinctive reputation. In turn, customers, investors, employees and other stakeholders will be more likely to do business with them. The stick that private regulation offers is the threat of reputational damage for deviant firms. Firms identified as being particularly bad examples of socially responsible behaviour can be singled out and publicly shamed. Reputational damage is likely to be most effective at curtailing bad behaviour when firms have already committed publicly to higher standards of behaviour.

Now that private regulation has proliferated, the question we should ask is this: how effective is reputation as a mechanism for holding firms accountable to the public? I believe the answer is mixed and suggests that reputation's regulatory influence is much more complex than the proponents of private regulation have theorized thus far. The proliferation of mechanisms of private regulation plunges us into a grey area where reputations and values are not given but socially constructed, the ethicality or morality of practice is contested, and reputational consequences are not always straightforward.

1. Private regulation and reputational incentives

A key mechanism underlying private regulation is a credible and legitimate signal of a firm's reputation in a particular area. As private regulation took hold in the 1970s, multi-stakeholder and non-governmental initiatives began to create a system of institutional signals of a firm's willingness to abide by responsibility norms. These initiatives sought to replace traditional regulatory mechanisms with certification standards or voluntary compliance statements that firms could adopt to demonstrate their willingness to conform (for an overview see [Utting, unpublished manuscript](#)). The first of these initiatives were established by quasi-governmental institutions, like the United Nations. The UN Global Compact, for example, represented an effort by a transnational body of state representatives to apply social responsibility standards to a global marketplace. Its stated goals were to raise awareness of corporate social responsibility and to serve as a hub for other voluntary partnerships between states and corporations. Ideally, the Global Compact would assist the corporate community in defining standards of a socially responsible corporate citizen, while also giving civil society groups a place at the table.

In addition to these quasi-governmental standards, civil regulation or regulatory standard setting established by third party associations, auditors and consultants has proliferated since the early 1990s. Certification systems provide a set of regulatory policy guidelines for firms to follow and are usually linked to some type of accreditation that signals to others, including industry peers, that the firm uses best practices. Sometimes these standards are industry-specific or apply to a particular issue or topic. Certification systems have been set up across a diversity of topics, including forestry, human and employment rights, environmental

performance, sustainable fishing or harvesting or anti-corruption. One of the first such systems was the Forest Stewardship Council, created in 1993 to help identify retail and other operations that used sustainable forestry practices (Bartley, 2007). Like most of the certification systems that followed, the Council was created following a number of scandals that put forestry industries under the watchful eye of activist groups and the public. Becoming a part of the Council allowed firms to signal their commitment to higher standards and avoid being stigmatized. Since that time the number of environmental certification systems has exploded. EcolabelIndex, a database that tracks all national and transnational environmental certifications, maintains there are currently 437 such certifications in 197 countries and 25 industry sectors.¹

Although one might hold the explosion of certification systems as evidence that private regulation is working, it also means that standards of varying quality and thoroughness now compete as potential signals of firms' commitment to higher standards. Competition among certification systems may create a race-to-the-bottom, much in the same way that governmental deregulation does (Djelic and Sahlin-Andersson, 2006). The proliferation of certification systems has also made it difficult for organizations' audiences to determine the reliability of the reputational signal of any single system (Schneiberg and Bartley, 2008). Two issues compound the reliability problem: (i) certification systems with looser standards are more widely adopted and (ii) many certification systems are now business-led rather than multi-stakeholder initiatives, about which many activists are sceptical. Given the heterogeneity in vast array of certification systems, it is clear that not every system promotes high standards and many appear to promote business interests more than they do the interests of the public they are meant to serve.

Thus, the very content of reputation signals is socially constructed and politically contested. Although certifications are meant to facilitate comparability and commensuration of reputation across very different types of markets (e.g. Espeland and Stevens, 1998; Timmermans and Epstein, 2010), in reality these certifications may only give the appearance of standardization and accountability. The proliferation of diverse standards creates strategic opportunities for firms that may prey on the ignorance of their consumer or regulatory audiences and use certification systems as impression management devices to establish a reputation for being socially or environmentally responsible without actually altering their behaviour. Rather than acting as signals, these certifications seem, instead, to be serving as symbols that corporations use to decorate themselves with the appearance of social responsibility.

¹<http://www.ecolabelindex.com/> (accessed on September 24, 2013).

Dynamics exist that may prevent these standards from losing their appeal as private regulatory devices. One of these dynamics is that competition between firms incentivizes some firms to differentiate their reputation in a positive way by becoming known for its social responsibility. Because some firms are serious about distinguishing themselves as responsible citizens, they will flock to those standards that raise the bar (Sabel *et al.*, 2000). These firms may seek to associate only with certification systems that promote the highest standards and that exclude firms that do not allow for regular monitoring and compliance tests. Another dynamic that helps prevent shirking are the presence of activist groups that seek to hold firms accountable to the standards for which they are certified. This bottom-up pressure to behave according to their commitments to the certifiers potentially inhibits some firms from using certifications merely for symbolic purposes (e.g. Overdevest, 2010). However, for this pressure to be effective, activists must be capable of identifying and targeting corporate shirkers and threaten their reputation.

2. Private regulation and reputational threats

Another mechanism through which private regulation works is through potential reputation threats created by activist groups. Research on social movements and corporate social responsibility has emphasized that stakeholder attempts to influence firm behaviour are rarely uncoordinated and diffuse; rather, in order for private regulation to be effective, private citizens often join forces and mobilize their resources in organized campaigns against corporate targets (e.g. King, 2008; Soule, 2009). Activists' main weapon against corporations is their ability to threaten corporate reputations by exposing malfeasance, lack of ethical decision-making or the use of normatively questionable practices. These negative claims present an image of the firm that runs contrary to the positively distinguishing image claims the firm makes about itself. Impression management, the skills and tactics that actors use to manipulate the shared perceptions that others have of them, underlies many of these contentious interactions. In particular, skilled activists seek to create negative perceptions of misbehaving firms and question their fundamental character, while those same firms seek to avoid the potential reputational costs this might impose by making positive claims about their character.

Punishing firms is only effective inasmuch as the media pay attention to the activists' claims. If nobody knows about the claims other than the activists, then the activists' actions will not alter public perceptions. However, inasmuch as activists grab media headlines, they are able to draw the public's attention to the targeted firm and its irresponsible behaviours and policies, which can subsequently affect the firm's reputation. Research shows that activist protests and boycotts that draw more media attention lead to larger declines in the target firm's stock price,

in part due to the reputational damage such attention inflicts (King and Soule, 2007; King, 2011). Thus, activists are highly dependent on media attention to inflict their punishment.

The quest to drum up media attention, however, means that activists are most likely to target firms that make attractive subjects of journalist inquiries. Large firms that have positive reputations make better candidates for media coverage than small, less prestigious firms. Not surprisingly, activists tend to target large, high reputation firms the most, irrespective of the egregiousness of their irresponsible behaviour (Bartley and Child, *forthcoming*; King and McDonnell, *unpublished manuscript*). In fact, one study showed that firms that have engaged in more socially responsible actions are more, not less, likely to be targets of boycotts than other firms (King and McDonnell, *unpublished manuscript*). The lesson seems to be that the worst offenders can often escape the notice of activists' protests if they are not highly visible or prestigious.

The adverse consequences of this selection process is that those firms that are the most frequent targets of activist actions are not necessarily the firms that most need to be regulated. Instead, it seems to be the same firms (the Nikes and Apples of the corporate world), year after year, that receive the majority of activists' outrage. These firms learn that responding directly to activists may only legitimate their claims further, and instead they choose to use impression management strategies that divert attention from the negative claims made by activists. For instance, after a firm is boycotted, they are much more likely to make claims about an unrelated prosocial behaviour, but rarely are these prosocial claims in direct response to the activists' original critiques (McDonnell and King, 2013). Thus, the actual source of the problem is rarely resolved. Reputation threats, then, seem to lead to ongoing impression management efforts, in which both activists and the corporate targets are equally engaged in using tactics to alter public perceptions, sometimes losing focus on the real goal of making substantive changes to business practices.

Finally, another critique made about the stick approach is that activists are not fully engaged in monitoring, perhaps in part because they are more concerned with creating media attention than they are with the more costly process of ensuring implementation (Seidman, 2007). The lack of weight behind monitoring makes it even easier for firms to respond to activist pressures through decoupled impression management. If this is the case, then firms should feel little pressure to actually implement their promised changes.

3. Conclusion

Unlike public regulation, where 'bad' behaviour is defined by legal dictum, private regulation leaves open the possibility for multiple interpretations of the same practice. Relying on incentives and sanctions to influence firms to be socially responsible

opens up the possibility for questioning the very definition of responsibility and manipulating the symbols by which firms demonstrate conformity to social responsibility norms. The ambiguity of rules and reputations leaves open the possibility that both stakeholders and firms will engage in impression management to shape the public's perceptions of their behaviour and its consequences for society. Firms may dedicate more effort to managing the impressions that their key audiences have of them than dedicating resources to conforming to the emerging standards. These entrepreneurial efforts to define and redefine standards and to engage in impression management have the potential to undermine private regulation and make it an ineffective mechanism to hold business responsible for the public good.

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From the colours of the rainbow to monochromatic grey: An $n = 1 + x$ analysis of Apple's corporate reputation, 1976–2013

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Corporate reputation represents the evaluations of a corporation by stakeholders (Fombrun and Shanley, 1990; Deephouse and Carter, 2005; Rindova *et al.*, 2005). Reputation sometimes has grey areas where evaluations are ambiguous or contested, often when the border between right and wrong is blurred or is changing (Bruhn, 2009). To develop theory regarding reputation formation and change within grey areas, I take a very micro-level approach and examine the reputation of one company, Apple, Inc. from the perspective of one individual stakeholder, me. I explore how the reputation of Apple changed over time based on changes

in company behaviour and shifting social norms. I reflect on my experiences with Apple, those of my friends and family, and those reported in the media (Deephouse, 2000; Gotsi and Wilson, 2001). That is, I put myself in the midst of a network that includes Apple, media reports of Apple and other users of Apple (Figure 1). I represent the ‘ $n = 1$ ’ in the paper’s title, and the number of people who share my reputational evaluations represent the ‘ $+x$ ’.

1. Theoretical and methodological foundations

Corporate reputation is generally regarded as the assessment of a particular corporation by its stakeholders relative to its competitors (Fombrun and Shanley, 1990; Deephouse and Carter, 2005; Rindova *et al.*, 2005). Reputation has three basic dimensions: being known; being known for something and generalized favourability (Lange *et al.*, 2011). Since stakeholders have different viewpoints and expectations, different stakeholders may have different reputations for the same corporation. For example, Carter and Deephouse (1999) demonstrated how Wal-Mart during the early 1990s was viewed by suppliers as a tough negotiator, by investors as a good investment and by consumers for having low prices. I take the idea that corporations have multiple reputations with different stakeholders as a starting point in this paper (Barnett and Pollock, 2012). Moreover, in grey

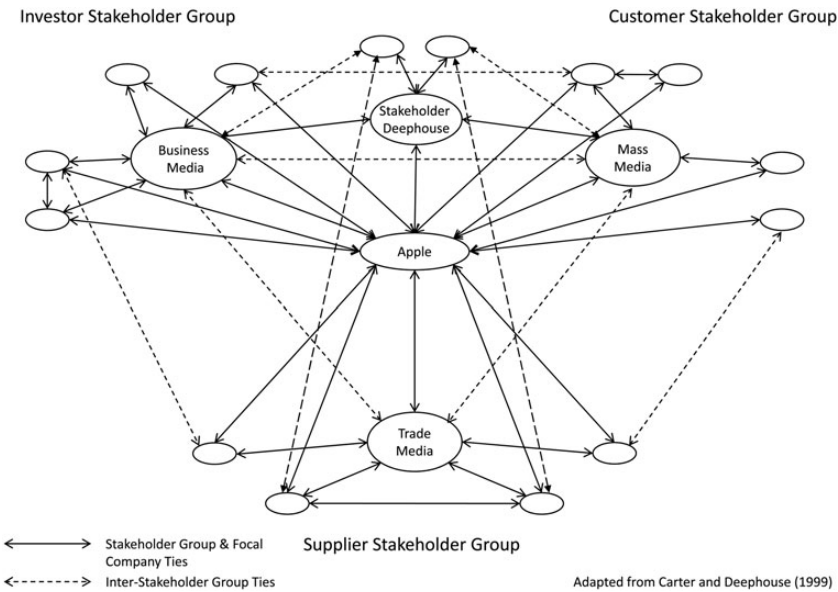


Figure 1 The network that formed Apple’s reputations with stakeholder Deephouse.

areas, social evaluations are ambiguous or contested as the border between right and wrong blurs or changes (Bruhn, 2009). Grey areas often emerge when there are allegations of fraud, scandal or other types of irresponsible behaviour. In these situations, sense-making by stakeholders often requires effort to bring clarity to reputational assessments.

In this paper, I apply these definitions to the history of Apple, Inc., formerly Apple Computer. I focus on the sense-making effort made by one stakeholder of Apple over its history, namely me. Apple has been a part of my life since its early years, as you will learn below. The primary method of this study herein is autobiographical. I thought carefully about my experiences since 1976 with Apple as a prospective employee, a product user, an investor, a business scholar with 17 years of research expertise related to corporate reputation, and a culturally and technologically aware individual. This autobiographical method is clearly biased, in that it reflects my understandings of Apple and of corporate reputation.

To enhance accuracy, I used the Internet to get information about Apple. Much to my surprise, I had great difficulty finding the history of Apple on the Apple website. My searches revealed 45 results for the 'Apple history timeline', 180 for the 'history of Apple Company', 516 for the 'history of Apple' and 545 for the 'history of Apple Inc'.¹ What I mostly found on the first pages of these results were movie trailers and downloadable widgets. I did not find a concise history of the company itself. So I turned to Apple, Inc., 2008, the Harvard Business School case I taught in my strategy class (Yoffie and Slind, 2008) and Wikipedia.²

Reputation is formed by the interaction of direct experience and the communicated experience of others (Gotsi and Wilson, 2001). Some readers will share my knowledge about Apple. Some readers may also share my assessments of the reputational impact of these reported facts. Some readers may also have similar experience to mine with Apple products. Since I rely on reported facts in this essay, we should be reminded that much reputational information comes from others and frequently is mediated (Deephouse, 2000; Gotsi and Wilson, 2001). Finally, it is important to remember that corporate reputation itself is a subjective concept because it is what some set of social actors believes about a corporation (Barnett and Pollock, 2012). In this paper, I comprise the set of social actors. As such, I leave it to you, dear reader, to determine whether my perspective on the corporate reputation of Apple, both holistically and for particular dimensions, is reasonable.

¹<http://www.apple.com/search/>

²http://en.wikipedia.org/wiki/Apple_Inc., http://en.wikipedia.org/wiki/History_of_Apple_Inc. and http://en.wikipedia.org/wiki/Criticism_of_Apple_Inc.

1.1 *The polishing of Apple*

Apple Computer was founded on April Fool's Day (April 1) in 1976 by two college dropouts, Steve Jobs and Steve Wozniak. Its founding vision was to 'change the world through technology', and its 'mission (was) to bring an easy-to-use computer to market' (Yoffie and Slind, 2008, p. 2). With the Apple I, they sought to impress other members of the Palo Alto-based Homebrew Computer Club.³ Early computers were built in Jobs's garage. The Apple II was introduced in June 1977, and it became a commercial success.⁴ The development of the row and column spreadsheet program VisiCalc made the Apple II more appealing to business users. Apple subsequently refined the Apple II and also introduced the Apple III, which was less successful.

During this period, I was learning to use mini-computers made by Digital Equipment Company, namely the PDP-8 and the VAX 780. I learned to program in Basic and Pascal. I used my first word processing software on the VAX in the winter of 1982 at Carleton College, and I really enjoyed it. Unfortunately, my professor took umbrage that I had not used a typewriter, although, as it turned out, time was on my side (cf. Ragovoy, 1963). When I pursued my Master's degree in Management at Georgia Tech in fall 1982, I used a mainframe computer for econometric analysis and word processing. As this was a technological university, not a liberal arts college no one ever questioned my use of a word processor, a phenomenon I now recognize as indicating legitimacy (Meyer and Scott, 1983; Deephouse and Suchman, 2008). I was aware of personal computers, but I viewed them as still too expensive. *Time* magazine acknowledged the trend by naming the personal computer as the Machine of the Year for 1982 (January 3, 1983, Vol 121, No. 1) instead of its usual practice of having a Man of the Year. Apple Computer figured prominently in this issue, with a feature on Apple and Steve Jobs (Cocks, 1983).

Reputation is formed relative to competitors, so my opinions about Apple also reflect my opinions of one of its major competitors, IBM. I grew up in Connecticut, a small industrial and commercial state known historically for insurance, firearms, military equipment etc. Large companies headquartered there included General Electric, United Technologies, Aetna and Travellers; I speculate these companies used IBM computers. Moreover, IBM's headquarters was in Armonk, New York, a town on the border of Connecticut, so many IBM employees lived in Connecticut. The dress code at IBM was flexible—you could wear anything as long as it included a blue suit and white shirt. For buyers of computers, 'there was a saying in American corporate circles: "No one ever got fired for buying IBM"' (Rawsthorn, 2011). My brother moved to Armonk in 1983, and the most common way to his house was to drive by the IBM headquarters which sat on a hill above the village.

³http://en.wikipedia.org/wiki/Steve_Wozniak

⁴http://en.wikipedia.org/wiki/Apple_II

The contrast between Apple and IBM was stark. It was dramatized in Apple's famous Super Bowl advertisement in 1984, which I learned this year was titled '1984'. This ad introduced the Macintosh computer by having a woman athlete run and throw a hammer through a giant television screen of a Big Brother-like character speaking to dark-suited minions marching mindlessly. As students looking for jobs in 1984, we were aware of that if we worked for Apple, we would not have to wear suits and might get stock options. So on the dimension of being known as a prospective employer, Apple had an attractive reputation (Turban and Cable, 2003; Lange *et al.*, 2011).

I had a number of positive experiences directly with Apple in the 1980s. I did not move to Silicon Valley after graduation from Georgia Tech in 1984. Instead, my first full-time job was as a monetary policy analyst with the Federal Reserve Bank of Atlanta. I was put in a cubicle, and there was my first computer—an Apple III. I used VisiCalc to create reports on monetary policy to prepare bank staff for Federal Open Market Committee meetings. I enjoyed learning to use the spreadsheet program, but shortly after my arrival, all the Apples were replaced IBM PC XTs. In a new job a few years later, I spent 2 months as a HyperCard developer on the Macintosh. This program was like a stack of electronic file cards which programmers could link together fairly easily, much in the way links now work on the Internet. I also enjoyed the Graphical User Interface commercialized by Apple, first on Lisa and then the Mac. At this point, I knew Apple for its good products (Rindova *et al.*, 2005; Lange *et al.*, 2011).

My mother started teaching mathematics at Trinity College in the early 1970s and in so doing was one of the first women to teach math at the university level. In the 1980s, Apple pushed the Macintosh hard to the education sector. My mother started using a Macintosh in the mathematics lab in the mid-1980s and shortly thereafter bought one for home. In 1991, my father switched from a CP/M machine to a Macintosh. In contrast, their three children were using IBM/DOS computers provided by their employers—so much for the generational divide in our family regarding computers! Nevertheless, my parents' good experiences helped Apple's product reputation.

I also bought 50 shares of Apple for around \$20 per share in 1987. Before I went back to get my PhD, I sold the shares, and I had doubled my money. So I liked Apple as an investment because it gave me a 100% return (less transaction costs). In retrospect, I should have held on to the shares until last spring and turned my \$1000 investment into \$16,000. *C'est la vie.*

Between 1985 and 1995, I observed Apple create a number of innovative software and hardware products that supported people's creativity, such as desk top publishing, music software and art programmes. There were favourable reports about Apple as a place where employees were empowered to create the future. As I look back at the history of the business, I now see that Apple was struggling financially.

Nevertheless, in the 1990s, I viewed the company favourably in all its activities. Apple liberated people, both employees and users, from drudgery. The IBM/Microsoft-DOS eco-system was not as good, even though I used it in my work because the University of Minnesota and Louisiana State University put PCs in my offices. Overall, Apple was polished and colourful.

1.2 *The greying of Apple*

During 1997–2007, Apple’s reputation with most stakeholders caught up to and passed its reputation with me. It was named America’s Most Admired Company in March 2008 by *Fortune* magazine by ‘upend(ing) one industry after another: consumer electronics, the record industry, the movie industry, video and music production . . . (and being) No. 1 among Fortune 500 companies for total return to shareholders over both the past five years (94%) and the past ten (51%)’ (Morris, 2008). The fact that it topped the Fortune ratings in 2008 should be no surprise given all the research about the attention business elites pay to financial return (Fombrun and Shanley, 1990; Fryxell and Wang, 1994). During this time, however, I saw a few blemishes on Apple’s reputation. And in the last few years, Apple has become known for some bad things (cf., Lange et al., 2011).

The development of Windows, especially 3.1., marked a change in my attitude towards Microsoft and PCs. Windows finally brought the Graphical User Interface and the mouse to PC users. Moreover, my employers kept supplying me with computers that ran Windows, such as IBM, Dell and Lenovo. Apple’s standard keyboards continued to lack the delete, page up, and page down keys that were invaluable for my most important scholarly task: re-writing using a word processor. Thus, my switching costs based on work routines were high, as I taught in strategy class. Adventurous computer users started using Linux and other open source platforms. So, product parity emerged that took a little shine off of Apple.

In the twenty-first century, Apple expanded its product line out of computers, most prominently into music players (iPod), digital distribution (iTunes) and smartphones (iPhone). Apple moved from making computers used by relatively few who produced creative works to making consumer products used by many to consume creative works. In the words of Christian Lander:

Apple products tell the world you are creative and unique. They are an exclusive product line only used by every white college student, designer, writer, English teacher, and hipster on the planet. . . . you need a Mac to creatively check email, creatively check websites, and creatively watch DVDs on planes.⁵

⁵<http://stuffwhitepeoplelike.com/2008/01/30/39-apple-products/>

Despite the claims that you could not be creative without an Apple, I now realize that I did succeed in writing some creative academic work using Windows' computers. Google Scholar and ISI Web of Knowledge informed me that others have cited my work. A few people actually complimented me in person—a very satisfying experience for which I was extremely appreciative. Apple was not a necessary condition for my creativity. And, believe it or not, creative works were even produced before Apple was founded in 1976!

Although many love their iPhones, I had many troubles with the iPhone 4S that I got in May, 2011. For almost 2 years, the battery would drain completely in a few hours even though no programs were running and the phone was asleep; another +X had this problem.⁶ A trip to the Apple Store for reinstallation did not fix the problem; instead, it created problems with my 9-year-old daughter, whose Smurfs' Village game that she played in the car was sent back to Level 1 from Level 22. Eventually, this battery drain ended after some update to iOS6, but Apple never admitted the problem. To save on power and roaming charges, I turned email to 'Fetch Manually', but it kept fetching mail when woken up from sleep. I found iTunes hard to use; although Apple made GUI popular, I have not figured out how to click and drag music or photos from iTunes to iPhone and vice versa. I had also heard reports that it is hard to transfer purchased items outside of the Apple ecosystem to other devices, so rather than promoting access to music, Apple had created switching costs that constrained people's freedom. Thus, Apple's high reputation for quality products declined during my direct experience of 2½ years with the iPhone.

Public awareness about supply chain issues grew with the case of child labour being used in Nike products, and this became a case study frequently taught in business schools. Other supply chain issues emerged as well, such as lead paint found in children's toys. Many supply chain issues arose from overseas production as companies in countries with high labour costs moved production to countries with much lower labour costs. Apple succumbed to these pressures, leading to some widely noted concerns in Apple's global supply chain. The first was Foxconn, maker of iPods and iPhones, where some employees committed suicide because of oppressive working conditions (Economist, 2010). Another was a supplier accused of violating child labour standards in 2013 (Armitage, 2013). Lastly, tin is an important component in mobile phones, and much tin comes from Indonesian mines criticized for poor environmental impacts and working conditions. Monbiot's (2013) headline summarizes both Apple's high reputation and the risks of losing it: 'The paragon of modern tech risks losing its shine by dodging queries about Indonesia, and an orgy of unregulated tin mining'. Apple talked transparency, but did not walk the talk. In contrast, competitors, specifically

⁶See also <https://discussions.apple.com/thread/4800878?start=0&tstart=0>

Samsung, Philips, Nokia, Sony, BlackBerry, Motorola and LG, admitted that such tin might be in their supply chain and that they would be working together to address these human rights and environmental concerns. So, Apple's production changed from two guys building computers in a Bay area garage, to a company manufacturing in California, and eventually to a multinational enterprise using Asian production that sometimes raised ethical concerns. Since I learned about these flaws in Apple's production process from others, especially in the media, this concern about Apple's declining reputation for supply chain management is not idiosyncratic to the $n = 1$ me. Instead, it provides evidence of the emergence of social norms on global supply chains and new expectations regarding full producer responsibility (Schrempf-Stirling and Palazzo, 2013).

Not only was the shine of Apple dimmed by the globalization of its supply chain, the globalization of its financial affairs also added shades of grey. Many national governments had been running deficit budgets, and some politicians began to ask about the effectiveness of corporate taxation. The answers that emerged were disquieting: many multinational companies—including companies scoring high in league tables such as Amazon, Google, Starbucks and Apple—arranged their financial affairs to minimize corporate income taxes by recording profits in countries that had low tax rates—such as Ireland (Baker, 2012; Halpin *et al.*, 2013). Many politicians, consumer groups and editorialists expressed their outrage. One company, Starbucks, bowed to the pressure and agreed to pay twice as much to the British government as its cumulative tax paid since 1998 (Colchester, 2013). This shifting of profits is facilitated by accounting professionals, so this practice seemingly has legitimacy (Deephouse and Suchman, 2008); moreover, it is not forbidden by regulators, indicating regulatory legitimacy (Deephouse, 1996). Nonetheless, a new social norm regarding corporate tax payments has emerged that challenges the reputation of Apple and other MNCs who use subsidiaries in low-tax countries. Future empirical research by financial market economists will determine if investors still like these companies.

The topic of this forum, grey areas and reputation, drew my attention to Apple's logo (Figure 2). In 1998, Apple replaced its rainbow logo with its current monochrome logo. This monochrome logo was adaptable to different colour schemes, including a silvery grey. The change of logo had little impression on me at the time. Only in the process of writing this paper did my views of the logo become negative as I thought about how much more I like rainbows due to their symbolism. Since I was a child, I have enjoyed seeing rainbows at the end of a summer evening's thunderstorm. Some social movements seeking greater human rights also used the rainbow, such the Rainbow Coalition and GLBT groups. And the song 'De Colores' celebrates the diversity of human experience. This leads me to reflect on how Apple today compares with the pioneering 1984 Super Bowl advertisement which defined Apple as a colourful non-conformist. I wonder what the difference is between those

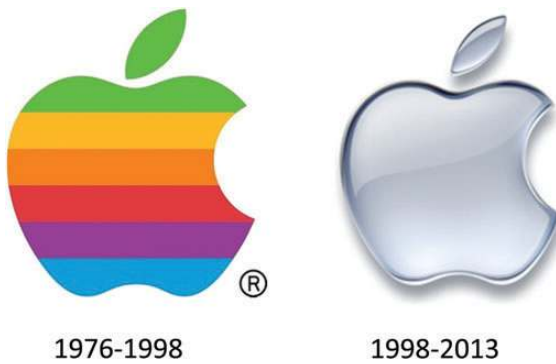


Figure 2 The evolution of Apple's Logo.

minions walking mindlessly in the 1984 advertisement to those people mindfully texting on their iPhones while mindlessly marching on stairwells and sidewalks—or more dangerously, mindfully texting while mindlessly driving.

Thus, the reputation of Apple in fall 2013 with me is no longer shiny—instead it is grey. Apple is known to me and others for many somethings, but not so favourably (Lange et al., 2011). Its product quality is no longer exemplary. Its global supply chain is subject to human rights and environmental challenges. Its global financial structure shifts profits away from the major industrial countries that are the source of these profits. And the ubiquity of its products has caused it to lose its uniqueness.

3. Conclusion

My personal review of the history of Apple's reputation has several contributions to reputation research. First, my empirical descriptions enliven the abstract definitions and dimensionalizations of reputation (Fombrun and Shanley, 1990; Lange et al., 2011). Second, I detailed how myself and others have been influenced by the emergence of social norms and how this emergence led to a reframing and 'greying' of Apple's reputation. Third, this research reiterates the importance of direct experience with a company, the communicated experiences of friends and family, and the role of media in sharing the experiences of others (Deephouse, 2000; Gotsi and Wilson, 2001). Information about such experiences and social norms move through a network like in Figure 1. Moreover, Figure 1 illustrates the $n = 1$ analysis of the reputation and the potential $+X$ people who share such a view.

Reputation is frequently viewed as the outcome of a competitive process where firms vie with each other for generalized esteem and perceptions of quality on certain attributes (Fombrun and Shanley, 1990; Deephouse and Suchman, 2008).

The importance of competitive comparisons is salient in the plethora of research that places reputation in the resource-based view of the firm and examines performance across firms (Barney, 1991; Deephouse, 2000). The case of Apple highlights how reputation can also involve comparisons of the same company over time as the company, social norms and stakeholders change. Since I previously viewed Apple as a ‘paragon’ and an ‘exemplar’ (Rindova *et al.*, 2007; Monbiot, 2013), its reputation with me fell far. Apple may be no worse than its competitors on some objective scale, but I never liked the competitors as much as I liked Apple in the past. Future research should investigate further the liabilities of a good reputation (Rhee and Haunschild, 2006).

This analysis of Apple also has implications for research on the reputations of others who are connected to Apple in some way. All the major mobile phone manufacturers have global supply chain issues; some may address these issues better than others, consistent with our general understanding of reputation as a competitive process (Fombrun and Shanley, 1990). The reputational impacts may also extend into the organizational field. Emerging norms regarding the behaviour of MNCs may affect the reputation of places where MNCs operate. The challenges of supply chains are well documented (Schrempf-Stirling and Palazzo, 2013); instead, I focus on tax avoidance. This could negatively affect the reputation of Ireland and might influence decisions to visit Ireland or buy Irish exports like music (e.g. U2) or beer (e.g. Guinness). The issue of tax avoidance could also draw negative attention to home country governments whose tax systems allow such avoidance and to professionals and professional organizations that help corporations avoid taxes. Thus, future research could examine the dynamics of how grey areas of reputation spread across not only competitors but also the organizational field.

The evolution of Apple’s reputation challenges the accepted wisdom about reputation being gained slowly and lost quickly, as discussed by Jackson and Brammer in their introduction. Apple’s reputation with me declined in a series of negative events related to particular dimensions over several years. *Forbes* also observed that Apple’s reputation score had fallen during 2010–2013 in the *Forbes*-Reputation Institute Global 100 survey of corporate reputations. Nielsen observed: ‘Apple has experienced several major challenges over the past few years: the loss of its visionary leader; legal battles; chatter about its products becoming uncool; and the stock wavering’. Nevertheless, Apple still ranked 12th of 100 firms, and its score of 74.65 on a 0–100 scale puts Apple in what the Reputation Institute calls the ‘strong/robust’ category (Smith, 2013). This difference between the average opinion of over 55 000 people in 15 countries and my non-numerical evaluation highlights how reputation lost with one stakeholder does not contemporaneously affect other stakeholders, many of whom are in different institutional environments (Brammer

and Jackson, 2012). Future research should investigate further the dynamics of reputation over time and among stakeholders across countries.

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