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Oops! I did it again: Effect of corporate governance and top management team characteristics on the likelihood of product-harm crises

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A B S T R A C T

Product-harm crises are ubiquitous in today's marketplace. Prior research has explored the negative consequences associated with these crises and highlighted effective crisis management strategies. Limited attention, however, has been devoted to exploring the antecedents of such crises. The authors use agency theory to explore corporate governance and top management team (TMT) characteristics that impact firms' likelihood of experiencing a product-harm crisis. They argue that family firms, firms with higher levels of managerial ownership, and firms in which the marketing function has a higher influence in the TMT are likely to exhibit a higher strategic emphasis on product quality. Strategic product-quality emphasis, in turn, mediates these firms' lower likelihood of encountering a product-harm crisis. An analysis of 116 S&P 500 firms across 2006–2011 provides considerable support for the authors' arguments. These results have important implications for practitioners and for scholars working in the areas of innovation, family business, and corporate governance.

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1. Introduction

A product-harm crisis is a discrete, well-publicized event wherein a firm's product fails to meet a mandatory safety standard, or contains a defect that creates an unreasonable risk of substantial harm, serious injury, or death to consumers (Dawar & Pillutla, 2000; Siomkos & Kurzbard, 1994). Each year, many firms across the globe encounter product-harm crises, resulting in huge social costs. Surprisingly, research in this area has been limited to two main streams. The first stream underscores the damage these crises cause to such intangible firm assets as brand value, customer value, and firm reputation (e.g., Dawar & Lei, 2009; Dawar & Pillutla, 2000; van Heerde, Helsen, & Dekimpe, 2007), and highlights how such pre-crisis characteristics as firm reputation, brand loyalty, and brand familiarity impact market reactions to product defects (e.g., Cleeren, Dekimpe, & Helsen, 2008; Rhee & Haunschild, 2006; van Heerde et al., 2007). The second stream, by contrast, recommends actions that a firm at the center of a product-harm crisis can take to minimize the crisis' costs (e.g., Chen, Ganesan, & Liu, 2009; Cleeren, van Heerde, & Dekimpe, 2013; Dutta & Pullig, 2011; Siomkos & Kurzbard, 1994). An important question, which has eluded the attention of scholars is, "Are some firms less likely to encounter a product-harm crisis?" Using agency theory and literature on managerial incentives, we explore whether certain characteristics related to firms' corporate governance and top management teams (TMTs) decrease firms' likelihood of encountering a product-harm crisis. We also investigate the mediating mechanism that links these characteristics to the likelihood of a product-harm crisis.

We argue that self-serving managers tend to under-invest in product-quality-related systems and processes, resulting in product quality levels that are sub-optimal from a value-maximization perspective. Corporate governance and TMT characteristics, more specifically higher managerial ownership, higher family ownership, and higher influence of marketing in the C-suite, help align managerial and shareholder incentives, resulting in firms exhibiting a higher strategic emphasis on product quality. Higher strategic product-quality emphasis, in turn, is likely to mediate these firms' lower likelihood of encountering a product-harm crisis. The conceptual framework of our article, for which our empirical study of 116 S&P 500 firms found broad support is shown in Fig. 1.

2. Theoretical framework and hypotheses

2.1. Strategic product-quality emphasis and relation to product-harm crises

A key manifestation of a firm's emphasis on product quality is the presence of a strong company-wide quality management program. We expect firms with a strong company-wide quality management program to be less likely to encounter a product-harm crisis.

We have this expectation, because firms with a strong company-wide quality management program implement "very careful business

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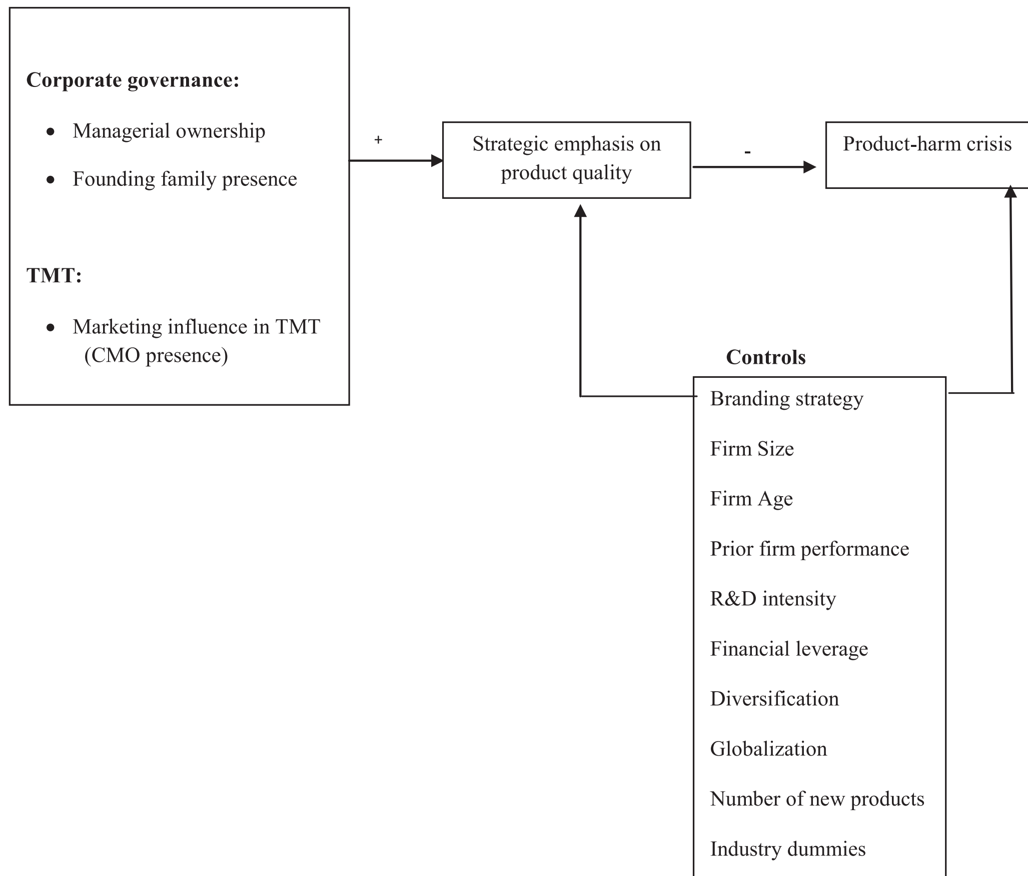

Fig. 1. Conceptual framework of the antecedents of product-harm crises.

processes with sufficient [product safety] checks and balances" (van Heerde et al., 2007, pg. 242). Furthermore, such firms distinguish themselves for their clear traceability and accountability: A missed quality test sends an immediate red flag and enables senior executives to follow the path easily to the cause. When the cause of a safety-related incident is identified, firms with superior quality management programs hold the responsible employee accountable in a manner that improves future work and tightens the safety process (Newman, 2011).

A significant percentage of product recalls are caused by faulty component parts or contaminated ingredients purchased from suppliers (Cleeren et al., 2013). Here again, firms with strong quality management programs consider vendors' previous record of product safety to be a key criterion in selecting their suppliers. Indeed, researchers argue that firms with strong quality-management programs minimize the likelihood of product defects by spelling out "required product specifications, expectations about delivery procedure and schedules, and tracking measures that ensure auditability from one end of the chain to the other" (Newman, 2011).

All in all, we expect a high strategic emphasis of a firm on product quality, as evidenced for example by the presence of a strong company-wide quality management program, to reduce the firm's likelihood of encountering a product-harm crisis. We next highlight how agency problems result in managers under-investing in systems and processes related to product quality, and how these agency costs can be reduced.

2.2. Agency theory and relation to strategic product-quality emphasis

According to agency theory (Fama, 1980; Jensen & Meckling, 1976), there is a potential lack of alignment of goals and preferences between agents (managers), and principals (shareholders). In a market without these agency problems, managers are expected to choose investments and make strategic resource-allocation decisions that maximize shareholder value. However, in practice, because the activities of managers are hard to monitor and the incentives of shareholders and managers misaligned, managers are in a position to pursue personal objectives, such as non-pecuniary consumption, at the expense of shareholders.

To the extent that product-harm crises significantly decrease shareholder value (Jarrell & Peltzman, 1985), the shareholder-value-maximization perspective would dictate that managers consider resource allocations towards product quality a key strategic priority. However, in light of the misalignment of goals and preferences, we would expect managers to exhibit shirking, perquisites consumption, or other opportunistic behavior. These agency problems are also likely to result in executives being myopic and cutting discretionary expenditure (Mizik, 2010) such as expenditure on product safety, to gain short-term financial rewards, resulting in a significant likelihood of the firm encountering a product-harm crisis.

Agency theory, and literature on managerial incentives would further suggest that disciplining mechanisms and incentives pertaining to managers' compensation and job security could influence the effort, investment, and resource allocation decisions these managers make with regard to product quality, in turn affecting the likelihood of product-harm crises.

2.3. Corporate governance: degree of managerial ownership

According to agency theory, managerial ownership is a tool that can help align the objectives of managers with those of shareholders (Hall & Liebman, 1998; Jensen & Meckling, 1976). Thus, we would expect a high

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