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The ecosystem of executive threats: A conceptual overview

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Abstract Executive risk, which is concerned with threats confronting directors and officers of business organizations, is a practically important but theoretically neglected aspect of corporate governance; this article re-conceptualizes this notion in a more theoretically complete context of 'executive threats'. The *Ecosystem of Executive Threat* model captures dyadic interactions between business organizations and seven distinct stakeholder groups, in addition to also accounting for the interaction-shaping influence of three distinct (stakeholder) expectation- and norm-shaping forces. Furthermore, the ecosystem conceptualization expressly differentiates between upside and downside threats, as well as non-estimable uncertainty, probabilistic risks and defined liability, with the goal of enabling a more comprehensive assessment of individual threats. Altogether, the ecosystem-based conceptualization supports ta more thorough forward-looking assessment of the totality of threats confronting directors and officers of business organizations by expressly contemplating not-yet-materialized but theoretically plausible dangers, in addition to those with established recurrence patterns.
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Introduction

The once-dominant view of a business organization as a separate economic entity operated for the benefit of its shareholders is giving way to the enterprise perspective, according to which firms are social institutions operated for the benefit of multiple stakeholders, including shareholders, employees, customers, creditors, regulators and

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the public at large (Purdy, 1983; Hendrikson and Breda, 1992). Implicit in the distinctiveness of individual stakeholder groups are differences in organizational interaction modes and motivations. For instance, shareholders tend to have infrequent, if any, direct contact with the business organization in which they hold stock and their expectations rarely extend beyond opportunistic arbitrage (Boesso and Kumar, 2009; Shah, 2011; Ezzine and Olivero, 2013; George and Lorsch, 2014). On the other hand, employees usually have constant direct interactions with the organization and their expectations tend to emphasize continuity and conditions of employment (Woods, 1993; Hubbard and Purcell, 2001; Beach, 2007; Oraman *et al*, 2011; Mason and Simmons, 2013); still other stakeholder groups, such as customers (Dawar, 2013; Greenberg, 2014) or creditors (Chinn and Ito, 2006; Houston *et al*, 2010), have periodic interactions with the company and their expectations tend to reflect the fulfillment of implicit or explicit commitments.

In a more general sense, enterprise theory suggests that business organizations can be viewed as networks of distinct constituents, or *stakeholder ecosystems* (Veblen, 1932; Shackle, 1970; Purdy, 1983; Dietz, 2006). The theory further implies that firms strive to promote an efficient and effective functioning of their stakeholder ecosystems through instituting formal systems of rules, practices and processes (Willet, 2009; Zhou *et al*, 2013). Broadly known as *corporate governance*, those rules aim to ensure accountability and fairness in organizations' relationships with individual stakeholder groups (Branson, 1993; Kay and Silberston, 1995; Kim and Nofsinger, 2004; Monks and Minow, 2004; OECD, 2012). Naturally, the degree to which firms meet those goals can be questioned by stakeholders, which in turn may lead to corrective or remediative actions. Remediative stakeholder actions can target firms as distinct legal entities, or firms' directors and officers as organizational decision makers, or both; furthermore, the nature and the underlying causes of those actions reflect the essence of individual dyadic relationships (Carter, 2001; Yu, 2005; Johnson and Clearfield, 2006), which means that, for example, remediative employee and shareholder actions are procedurally different, in addition to stemming from different root causes.

In general, remediative stakeholder actions are reactive, as they reflect stakeholder evaluations of *a priori* management actions in the context of obligations imposed by formal and informal rules comprising corporate governance (Carter, 2001; Johnson and Clearfield, 2006; Adams *et al*, 2011). Implicit in that characterization is that remediative actions are evidence-based, and thus those actions effectively imbue intent to observed outcomes. A word of caution: The term 'evidence', as used in this context, does not necessarily mean objective, irrefutable facts – rather, it connotes inferences drawn by stakeholders from information available to them. This is a critical distinction, explored in more depth later, in the context of the business judgment rule.

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Yet, not all governance-related adverse stakeholder actions are reactive – it is possible for stakeholders to act in anticipation of future events (Husted and Allen, 2011). A case in point is a shareholder's decision to either increase or decrease his/her investment in the company, which generally is a reflection of that shareholder's belief regarding the future prospects of the company. Considering that shareholder theories of corporate governance (Jensen and Meckling, 1976; Charkham, 1994; Windsor, 2009) suggest that the primary function of a firm's management is value maximization (Kay and Silberston, 1995; Ross and Crossan, 2012), positive anticipatory shareholder action – further investment – may further that goal, which means that the reverse action – divestment – may adversely affect it. Hence, in contrast to evidence-based remediative actions, anticipatory stakeholder actions can be characterized as uncertain.

Although the aforementioned economic considerations tend to be the dominant driver of investment-related decisions, the importance of business organizations' 'good corporate citizenship' cannot be overlooked. Assessment of the extent to which business organizations fulfill the already-in-place as well as the emerging societal responsibilities continues to gain importance as a dimension of organizational performance, as well as an important contributor to consumer choice (Burke, 2005; Sjostrom, 2010). In many regards, the resultant rise of shareholder (Goranova and Ryan, 2014) and consumer (Noe and Rebello, 1995; Hollenbeck and Zinkhan, 2006; Glickman, 2009) activism may present a more direct threat to business organizations and their managers given that activists often seek change in organizational direction by means of direct management involvement (Logsdon and Van Buren, 2008), or through reputation-focused, grassroots campaigns (Glickman, 2009; Becchetti *et al*, 2012).

From the standpoint of organizational management, the possibility of any of the firm's stakeholders taking undesirable actions is at the core of *executive threat*, a summary construct that encapsulates dangers that are endemic to the discharge of corporate directors' and officers' duties. Executive threat encompasses adverse as well as uncertain stakeholder actions, a distinction that has been overlooked by researchers and practitioners alike.

Adverse stakeholder actions are consequences of evaluations of managers' fulfillment of explicit or implicit obligations created by formal rules and informal norms comprising corporate governance (discussed in more detail in the next section). Those actions most commonly manifest themselves in allegations of management misconduct, which encompass a wide range of behaviors such as making misleading or deceptive statements regarding the company's performance, violations of binding statutory requirements or an outright fraud (Drew *et al*, 2006; Bowlin, 2011). This dimension of executive threat traditionally delimited the practice-shaped conception of executive threat.

Uncertain shareholder actions represent the second – and often overlooked – dimension of executive threat, encapsulating expectations of economic efficacy

and societal appropriateness of managers' strategic decisions. The former is focused on business performance aspects of corporate managers' strategic choices, where positive evaluations typically lead to steady or increased stock investment, while negative ones tend to spur divestment (Iverson, 2013). The latter, on the other hand, can be seen as a manifestation of emerging or changing social consciousness – as such, it encompasses broader stakeholder sets' evaluations of the degree to which management's strategic decisions are in keeping with corporate social responsibility norms. As noted earlier, it commonly manifests itself in the form of shareholder (Burke, 2005; Parthiban *et al*, 2007; Van Cranenburgh *et al*, 2013; Goranova and Ryan, 2014) or consumer (Noe and Rebello, 1995; Hollenbeck and Zinkhan, 2006; Glickman, 2009) activism.

Hence, at its core, the notion of executive threat encompasses the narrower concepts of *executive liability*, which are binding obligations emanating from statutory and/or regulatory demands (Debenham, 2006), and *strategic risk*, broadly defined as potential earnings' response to adverse business decisions, improper implementation of decisions, or lack of responsiveness to industry changes (Andersen *et al*, 2014). In terms of outcome, executive threat can have numerous manifestations including reputational damage, loss of market value, regulatory sanctions, fines and related costs; in practice, securities and derivative litigation are perhaps the best known, most visible and most closely watched of all executive threat expressions (Cornerstone Research, 2014).

In spite of its considerable practical importance, executive threat has received relatively little theoretical attention, to the extent that its conception is shaped almost entirely by the currently available risk transfer mechanisms offered in the commercial insurance marketplace (that is, the so-called 'directors' and officers', or 'D&O' insurance), where it is commonly referred to as 'executive risk' or 'executive liability'. Hence, it is the purpose of this research to fill the void in the current understanding of this important but little understood dimension of business risk by offering a broad, conceptual overview of its structure and root causes.

Corporate governance

Conceptually, executive threat can be seen as a logical consequence of corporate governance, defined earlier as a formal system of rules, processes and practices aimed at controlling and directing business organizations (Windsor, 2009). In a more operational sense, corporate governance can be broken down into two distinct dimensions: (1) operational management and (2) supervisory oversight (Kay and Silberston, 1995; Kim and Nofsinger, 2004; Monks and Minow, 2004; Gourevitch and Shinn, 2005). The first dimension implies active control over day-to-day activities of a firm and it typically rests with executive officers, defined here as those entrusted with the authority to carry out rules, processes and practices aimed at controlling and directing business organizations.[1] In large

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business organizations, those positions tend to be staffed by professional managers, hired by business organizations and entrusted with controlling their day-to-day operations (MacAvoy and Millstein, 2003; Bebchuk and Fried, 2004). The second dimension – supervisory oversight – is the domain of boards of directors, which are bodies charged with jointly overseeing activities of the executive leadership (IoD, 2005; Lorsch *et al*, 2005).

In contrast to executive managers, corporate directors tend to be elected by shareholders[2] (a common practice in stock corporations) for the purpose of supervising activities of corporate executives (Kim and Nofsinger, 2004; IoD, 2005). Although ideally independent of one another, the two organizational management bodies tend to overlap because of a common practice of the highest-ranking executive officers also serving as members of the board of directors. The merit – or lack thereof – of such practices notwithstanding, when considered from the standpoint of risk, the notion of corporate governance encompasses both the operational management and supervisory oversight dimensions of organizational management (IoD, 2005).

Corporate governance in academic research

As a subject of theoretical research, governance of business organizations received relatively little attention until the early 2000s, when a string of corporate scandals (for example, WorldCom, Enron in 2001; Adelphia Communications, Arthur Andersen in 2002) attracted wider attention to that topic (Harris, 2008). The resultant research efforts, however, focused primarily on normatively prescriptive aspects of governance, as exemplified by regulatory oversight (for example, Hooghiemstra and van Manen, 2002; Colley, 2003; Kim and Nofsinger, 2004; Monks and Minow, 2004; McNulty *et al*, 2011; OECD, 2011; Effiong *et al*, 2012; Bruner, 2013; Royaee and Dehkordi, 2013). Though important, the prescriptive view of corporate governance does not expressly address the potential conflict of interest emanating from the separation of ownership and management, characteristic of large, public business organizations (Finegold *et al*, 2007; Windsor, 2009). Variously known as the principal-agent problem (Hindley, 1970; Fama and Jensen, 1983) or agency dilemma (Eisenhardt, 1989; Schotter and Weigelt, 1992; Parks and Conlon, 1995; Stroh *et al*, 1996; Pepper and Gore, 2013), it tends to arise when corporate managers (agents) make decisions on behalf of shareholders (principals) under conditions of divergent interests and asymmetric information. Within the confines of executive threat, the management-ownership misalignment may lead to non-conformance of managers' behaviors to shareholders' expectations of those behaviors, as it is well known that expectations influence perceptions of behavioral outcomes (Tversky and Kahneman, 1974, 1981; Tesser, 1988; Ajzen, 1991; Schultz and Lepper, 1995; Ochsner *et al*, 2002; Lieberman, 2005).

The agency dilemma-encapsulated effects are even more critical to developing better understanding of corporate governance failures. As a group, shareholders of public stock companies expect clear, timely and accurate disclosure of pertinent information (Powell, 2007; Chen, 2010; Morris *et al*, 2012); those expectations can be viewed as a direct consequence of securities laws,[3] which themselves reflect prevailing socio-political priorities. When looked at from a strictly normatively prescriptive point of view, shareholder-related organizational governance is effectively reduced to a set of 'what, when and how' rules of management disclosures (Arshad *et al*, 2009; Garcia and Guillamon-Saorin, 2011; Armstrong *et al*, 2014). Such a limited perspective, however, cannot explain governance failures because without evidence of intent to deceive on the part of management, disclosure errors or omissions could be excused under the broad protections offered by the business judgment rule (Powell, 2007). Stated differently, to provide substantive explanation of corporate governance failures it is necessary to expressly differentiate between unintended errors or omissions and willful concealment or misrepresentation of truth – while the former does not provide immediate relief (that is, the accuracy of public disclosures is an absolute requirement, which means that intentional and unintended errors are treated essentially the same), the latter may precipitate otherwise avoidable consequences. A case in point: In an average year more than 1000 US exchanges-traded companies restate some part of their annual disclosures[4] (US SEC Form 10 K); at the same time, fewer than a quarter of that number of public US companies are accused by their shareholders of some aspect of misgovernance, via a mechanism known as shareholder litigation.[5] In almost all cases, the underlying accusations stem from alleged willful misconduct (Bebchuk and Fried, 2004; Johnson and Clearfield, 2006; Chung and Wynn, 2008; Harris, 2008), which suggests that disclosure errors that are deemed unintended are considerably less likely to trigger adverse shareholder action. All considered, the agency dilemma draws attention to managers' motives (Korine and Gomez, 2014) and by doing so adds additional explanatory power to the normatively prescriptive perspective of corporate governance.

To date, governance-related investigations of the principle-agent problem have focused on examining the impact of key decisions, such as initial public offerings (Lowry and Shu, 2002; Lowry, 2003), mergers and acquisitions (Lin *et al*, 2011) or earnings reporting (Chung and Wynn, 2008). Although clearly important, those decisions nonetheless represent but a few of the areas where misalignments of owners and managers of business enterprises may possibly affect corporate governance outcomes. Another case in point is the once-obscure practice known as 'stock option backdating' (Lie, 2005), which made headline news in 2005 leading to more than 100 investigations by the US Securities and Exchange Commission and the Justice Department, ultimately resulting in about 50 civil and more than 2 dozen criminal lawsuits.[6] The essence of the backdating practice was to allow the recipients of stock options

to select the date of award at a later time, which effectively gave them the ability to maximize the future value of those awards[7] (Weinstein, 2010). Clearly an example of corporate misgovernance (Cleary, 2007; McCarrick and Pesso, 2007), option backdating exemplifies one of many potential manifestations of the principal-agent problem that may directly and adversely impact the governance of business organizations and that are not opened to outsider scrutiny. Hence, it follows that limiting governance research to only high-profile, key decisions might yield an incomplete understanding of the potential impact of the principal-agent problem[7] on corporate governance.

Looking toward the future, research addressing the governance of business organizations should start with framing the scope of the problem in a broader framework of the stakeholder ecosystem conceptualization mentioned earlier. Cast in that context, governance and any of its possible influencers, such as the principle-agent dilemma, can be analyzed as a system of dyadic interactions, where organizational insiders, most notably corporate directors and officers, both affect and are affected by organizational outsiders, which are the distinct organizational stakeholder groups. Beyond offering a more conceptually complete picture, making use of a 'system' (as in 'ecosystem') representation has the advantage of allowing a clear delineation of the expectations of individual constituent groups, as well as individual dyadic interactions and contextualized risks that are endemic to roles of corporate directors and officers.

Stakeholder Ecosystems

There is a long tradition of likening different aspects of business to natural phenomena, with natural science terms such as evolution (Bendle and Vandenbosch, 2014), natural selection (Lambert, 2005; *The Economist*, 2012), life cycle (Gecevska *et al*, 2011; Dumas *et al*, 2013) or – of particular interest here – ecosystems (Bertin *et al*, 2013; El Sawy and Pereira, 2013) offering compelling explanations for observed social and economic phenomena. As a scientific concept, *ecosystem* is the totality of living organisms and non-living elements inhibiting a particular area; in a given ecosystem, living organisms interact with each other and with non-living elements. The natural – that is, biological – definition of ecosystem implies a certain degree of distinctiveness, as well as a certain degree of interconnectedness among the living and non-living components comprising a given system. If an ecosystem can be assumed to have a purpose, it would most likely be to perpetuate itself and, by extension, the purpose of its living elements can be assumed to be survival (Schmitz, 2010).

Given the basic outline of a natural ecosystem it is easy to see its close parallels with business: 'the totality of living organisms and non-living elements inhibiting a particular area' can be likened to 'the totality of firms competing in a particular industry'; furthermore, ecosystems' purpose of 'self-perpetuation' is

essentially the same as the commonly used 'going concern' assumption characterizing business organizations. Last, the application of the concept of ecosystems to a narrower context of corporate governance retains those similarities: *Stakeholder ecosystems* can be thought of as networks of organizational constituents interacting with firms in a manner that contributes to those firms' remaining going concerns.

There are several important contributions that the notion of stakeholder ecosystems makes to understanding of executive threats. First, it provides the basis for demarking groups with a constituent interest in the broadly defined – that is, spanning supervisory oversight as well as operational management – corporate governance, along with forces that shape the nature of those interactions. Second, it lays the foundation for understanding of the 'structure' of executive threat, in terms of dyadic interactions and the interaction-shaping forces. Third, it is suggestive of potential manifestations of stakeholder-specific, threat-bearing outcomes.

Key stakeholder groups

At its most rudimentary level, a business organization can be seen as a group of individuals joined together in pursuit of commercial goals (O'Shaughnessy, 1966; Levin, 1998). In a legal sense, there are several distinct types of business organizations, of which corporation is the most common. One of the distinguishing characteristics of a corporation is that it is considered a stand-alone legal entity that is both distinct and independent from the individuals who make it up (Emanuel, 2005; Palmiter, 2009). In that sense, the very individuals who comprise a business corporation can be thought of as organizational constituents, rather than the organization itself (Freeman, 1984). Furthermore, as hinted by the notion of stakeholder ecosystems, any entity external to the organization that interacts with it can be considered its constituent, defined here as any entity that contributes to the creation or the consumption of the firm's economic output, or one that regulates its commercial behavior.

Naturally, considering the many differences that exist among industries and, to a lesser degree, individual companies within industries, the number of constituent groups may vary across organizations. Nonetheless, a common core of stakeholder groups can be identified that cuts across all industries – those common stakeholder groups are graphically depicted in Figure 1.

Shareholders, defined as any person, company or other entity that owns at least a single share in a company (Freeman, 1984; Adams *et al*, 2011), are the first of the seven common stakeholder groups. Although it is rare for shareholders to have direct interactions with organizations in which they own stock, as owners they nonetheless have numerous rights, many of which translate into binding obligations – or liability – on the part of the management (Sametz, 1991). (It should be noted that, in the United States, the exact makeup of those rights

Figure 1: Organizational stakeholders.

depends on the state in which a company was incorporated, as laws governing corporations are derived from state statutes;[8] that said, nearly half of all US public companies, and more than 60 per cent of Fortune 500 corporations, are incorporated in the state of Delaware.)

The second key stakeholder group is employees, defined as persons who work for a business enterprise in return for financial or other compensation (Jones, 1997; Drucker, 2002). Within the confines of stakeholder ecosystems, there are two distinct employment classes: executive and non-executive (McNulty *et al*, 2011). The former shape and enforce organizational policies that the latter are expected to follow, which points to noticeably different interactions with the organization: From the standpoint of corporate governance, executive employees are effectively legal proxies of the organization they manage and hence can be viewed as endogenous to the firm, while non-executive employees are exogenous to the firm, and thus can be considered a distinct external stakeholder group.

Regulators are the next key stakeholder group. Although there are numerous federal regulators (more than 500 in the United States, according to official sources),[9] not all have rulemaking powers, and of those that do, not all have oversight over business conduct of organizations (Custos, 2006; Cavazos, 2007). Overall, regulatory agencies with rulemaking powers and business conduct oversight can be grouped into two broad categories: (1) business-general and (2) industry-specific (Congressional Research Service, 2003). The former, exemplified by the Securities and Exchange Commission, the Federal Trade Commission or the Equal Employment Opportunity Commission, regulate those aspects of business that apply to all companies, while the latter, exemplified by the Food and Drug Administration or the Nuclear Regulatory Commission, focus on matters that are specific to only certain industries.

Hence, it follows that while all organizations that are involved in commercial activities within the United States are subject to at least one US regulatory agency's oversight, the number of applicable regulatory overseers will vary across industries and, to a lesser degree, across companies. It should also be noted that individual states (in the United States) regulate some limited aspects of business, such as insurance, which may translate into additional regulatory demands.

Considering that no business organization can remain a going concern without earning income from the sale of its products and/or services (Drucker, 2001), customers should be viewed as yet another distinct group with a constituent interest in business organizations. Within the confines of executive threat, customer constituency stems from the possibility of organizations' products and/or services, over which executive managers have ultimate oversight, causing physical injuries or other harm, such as physical injury caused by poorly designed products or financial losses resulting from reckless advice (Poust *et al*, 1977; Cantor, 2011).

The next two stakeholder groups – creditors and suppliers – are similar, yet distinct. They are similar insofar as both provide inputs that are required by the firm, which means both sets of relationships tend to be governed by contractual agreements centered on the truthfulness of all requisite disclosures as well as adherence to the agreed-upon terms (IoD, 2005; Houston *et al*, 2010). They are distinct because with regard to occurrence, the possibilities of creditor and supplier non-performance are independent of one another.

The last and probably the most unlikely organizational stakeholder group are the firm's competitors. It is important to note that when taken at its face value, the nature of competitor constituency is fundamentally different from those discussed above: While virtually all of the other organizational stakeholders have symbiotic relationships with business organizations in which they hold constituent interest, that is generally not the case with competitors (Woiceshyn, 2011). However, when looked at from a more macroeconomic point of view, firms that compete in a particular product or service category have a vested interest in making sure that others (that is, competitors) adhere to the agreed-upon 'rules of engagement', broadly known as trade practices. Thus, following that line of reasoning, firms have constituent interest in the governance-related decisions of their competitors.

Norm-shaping forces

The preceding discussion of the seven constituent groups suggests that a combination of legally binding obligations and behavioral norms gives rise to stakeholder group-specific expectations, captured by shareholder-organization dyads. In terms of explicit rules, shareholders of public companies expect the management of those companies to provide timely, complete and accurate

disclosure of financial performance (Powell, 2007; Chen, 2010; Morris *et al*, 2012), as spelled out in securities laws that govern the initial issuance (the US Securities Act of 1933) and the subsequent trading (the US Securities Exchange Act of 1934) of public securities. Implicit norm-wise, shareholder expectations are also influenced by the ever-changing socio-political sentiments reflecting shifting and emerging societal priorities (Powell, 2007; Becchetti *et al*, 2012; Armstrong and Green, 2013; Ezzine and Olivero, 2013), all of which can be conceptualized as *forces* that ultimately shape the nature and scope of shareholder expectations. Taken together, the already codified rules of corporate management conduct, such as securities laws, along with the more abstractly defined social priorities can be broadly described as the political dimension of the forces shaping stakeholder group-specific expectation.

A distinct, though conceptually related expectation-shaping influence takes the form of judicial decisions, especially those made within the context of torts, or civil wrongs (as opposed to criminal transgressions, which fall outside the scope of this research). As a common law country, the United States derives many of its legal standards from judicial decisions (Hill, 2010; Bruner, 2013), which tend to fill the legal void in matters not expressly addressed by existing legislative acts (captured in the political forces discussed above). It is worth mentioning that in everyday business vernacular, political (that is, legislative) and judicial forces are often lumped together under a single 'legal requirements' umbrella – though in some situations such a generalization may be warranted, it is important to note that the two are separate and distinct.[10]

In addition to the political and judicial forces, stakeholder expectations are also influenced by market forces, which, slowly, at times almost imperceptibly, redefine the economic aspects of prevailing attitudes. For example, organizational stakeholders' expectations regarding manufacturing location (Kwangsun and Ching-Lai, 1985; Honeycutt *et al*, 1993; Gailbraith and De Noble, 1995) and employment terms, such as full time versus part time or benefits versus no benefits (Peterson, 2005; Armstron and Green, 2013), have been redefined by a slow marketplace shift, the former taking the form of off-shoring and the latter manifesting itself in a steady growth in the contract staffing penetration rate (which reached a record high of 2.06 per cent in 2013, growing at nearly 10 per cent year-over-year, according to the US Bureau of Labor Statistics). Similarly, market forces are now reshaping organizational stakeholders' expectations with regard to carbon emissions (Das and Ahlgren, 2010; Bahn *et al*, 2012), sustainability (O'Dwyer *et al*, 2011; DuBois and DuBois, 2012) and social responsibility (Horrigan, 2010; Becchett *et al*, 2012).

The three distinct expectations and behavior-shaping forces – political, judicial and market – are exogenous to the individual stakeholder-organization dyads. Taken together, those forces, along with the seven stakeholder groups, comprise the structure of stakeholder ecosystems of business organizations, which is graphically depicted in Figure 2.

Figure 2: Organizational stakeholders and norm shaping forces.

The Notion of Executive Threats

The agency dilemma discussed earlier highlights one of the potential sources of friction in stakeholder-organization dyadic interactions: By virtue of being insiders, managers (that is, agents) of business organizations have more complete and timely knowledge of their companies' current performance and future prospects than those companies' owners (that is, principals) – when the latter have reasons to believe that the information disclosed by the former is misleading, incomplete or altogether untrue, they can take legal action seeking monetary damages (Carter, 2001; Johnson and Clearfield, 2006). Commonly known as shareholder litigation, those actions can be reputationally damaging and economically costly (that is, the top 10 most expensive settlements[11] all exceed the $1 billion mark).

Although the agency problem does not extend beyond shareholder-organization dyads, agency dilemma-like effects permeate the entire stakeholder ecosystem because political, judicial and market forces-shaped expectations of stakeholder groups can be thought of as implied contracts between principals (stakeholder groups) and agents (the organization). To fully appreciate the intricacies of stakeholder ecosystem-encapsulated interdependencies, it is essential to address the inherent definitional duality of what constitutes 'corporate business organization'. From the legal point of view, corporation is a person-like entity, separate and distinct from individuals that comprise it (Pickering, 1968), while from the organizational theory point of view it is a group of individuals joined together in pursuit of commercial goals (Rogers, 1975). Thus, it follows that the earlier discussed remediative or anticipatory stakeholder actions, the totality of which constitutes broadly defined executive threats, can be directed at organizations as separate legal entities, or at

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organizational decision makers, namely, corporate directors and officers, as named individuals.

Sources of executive threats

Although there are numerous, diverse manifestations of executive threat (detailed later), all are causally linked to the concepts of the *business judgment rule* and the *duty of care*. The former is a corporate law notion that states that '… directors of a corporation … are clothed with [the] presumption, which the law accords to them, of being [motivated] in their conduct by a bona fide regard for the interests of the corporation whose affairs the stockholders have committed to their charge'.[12] Stated differently, the business judgment rule extends a certain degree of immunity to corporate managers, so long as they manage organizations to the best of their abilities (Greenfield, 2006; Radin *et al*, 2009; Nichols, 2012).

The duty of care, on the other hand, captures the legal responsibility placed upon corporate directors and officers, which demands adherence to a standard of reasonable care, while engaging in behaviors that could foreseeably harm the constituents of companies they govern (Jaffey, 1992; Calnan, 2009; Loughrey, 2013). There are numerous manifestations of the duty of care that relate to executive actions, with one of the most visible ones being that of public disclosures: As custodians of organizations, corporate managers are responsible for the accuracy of oral and written statements that reflect their companies' performance, prospects and the overall well-being (Lees, 1981; Kross and Suk, 2012). It is instructive to note that the scope of directors' and officers' duty of care, especially in the area of expected prudence and competence, has been steadily expanding, especially following the passage of the corporate governance scandals-inspired US Sarbanes-Oxley Act. It is also important to note that the disclosure accuracy is an absolute requirement, meaning that it makes no distinction between intentional and unintended errors or misstatements – that is, it does not require a discernible intent to deceive.[13]

All considered, in their role as corporate decision makers, executive managers and boards of directors face a myriad of threats that emanate directly from their positions. Some of those threats reflect market-driven uncertainty of the efficacy of their strategic choices, others reflect risks associated with known (because of past occurrences) but still not perfectly deterministic events, and still others reflect the possibility of violating any of the applicable rules of conduct. In more operationally clear terms, those three distinct types of threats facing corporate managers can be re-cast in more general terms of uncertainty, risk and liability.

Uncertainty, risk and liability

As terms-of-art, 'executive risk' and 'executive liability' tend to be used interchangeably; the same holds true for the notions of 'uncertainty' and 'risk'.

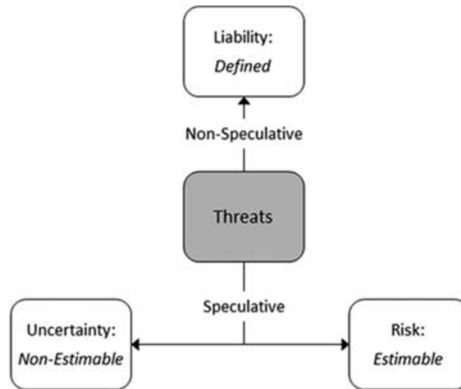

Figure 3: Types of organizational threats.

The inappropriateness of those practices becomes quite apparent in the context of knowability of adverse events (Banasiewicz, 2014), as occurrence of events can range from completely random to fully deterministic, with many falling in between these two extremes. Taken a step further, this line of reasoning suggests that some events are not at all estimable, and are thus not knowable; others are estimable but speculative (that is, probabilistic), and thus approximately knowable, while still others are deterministic, or exactly knowable. Thus, it follows that 'uncertainty' can be used to demark non-estimable events, 'risk' can be used to demark probabilistic (that is, estimable) events, and 'liability' can denote threats that have a defined chance of occurrence. The three manifestations of executive threat are graphically depicted in Figure 3.

Regardless of their degrees of knowability, executive threats arise when directors and/or officers of a business organization engage in behaviors that can either cause harm to any of the earlier delineated organizational stakeholders, or fall outside of the norm allowed by the business judgment rule (Sametz, 1991; Debenham, 2006; Ezzine and Olivero, 2013). Those behaviors can be quite wide-ranging for two distinct reasons: (1) harm can take on a number of different forms and (2) it can be a result of illegal or just inappropriate behaviors. The combination of these two precipitating factors points to a fundamental distinction between upside and downside threats.

Upside versus downside threats

The preceding discussion implicitly casts executive threats in the context of only those events that carry negative consequences, which effectively ignores one of the core responsibilities of corporate management: strategic planning (Freeman, 1984; Drucker, 2001). This is an important consideration as in addition to being expected to adhere to principles of good corporate governance, business

managers are also expected to pursue shareholder value maximization (Sametz, 1991; Lorsch *et al*, 2005). In more operationally clear terms, those two sets of expectations give rise to *downside* threats, which are actions that can only negatively impact shareholder value, and *upside* threats, which are actions that can have a potentially positive impact on shareholder value. For example, management of a retail company faces a downside threat of employment practices class action being initiated by a group of disgruntled employees, while at the same time it faces an upside threat of pursuing an ineffective strategy.

Within the confines of executive decisioning, downside threats represent consequences of actions that should be avoided and are, in principle, avoidable; those threats tend to be company non-specific – for instance, botched financial reports carry essentially the same potential consequences for all companies, regardless of industry or other characteristics. Thus, the possibility of downside threats can be noticeably reduced, if not altogether eliminated, by means such as simply avoiding event-triggering behaviors. Upside threats are starkly different in that regard – in fact, under some circumstances the very event that has, for instance, a decisively negative impact on one organization might have an equally positive impact on another firm. A good illustration of that invariance is offered by the Great Recession that followed the 2007/2008 financial crisis. This deep and prolonged global economic slump clearly had a negative impact on many, if not most, business organizations – still, some businesses prospered during that time. The quintessential fast food rivals, McDonald's and Burger King, offer a compelling example of the very different consequences of the same event: While the former's sales and stock price rose during the recession (by 4.6 and 18 per cent, respectively), the latter's share price slid more than 30 per cent and its financial performance worsened to the point of effectively forcing the company to sell itself (to investment firm 3 G Capital) to avoid outright bankruptcy.

Tying It All Together: The Ecosystem of Executive Threats

Practitioners tend to frame the notion of 'executive risk' almost entirely in terms of risk transfer mechanisms,[14] most notably commercial insurance. Relying on such narrow and retrospective definition is myopic, as it can severely impair risk management efforts by drawing attention to only the established threats. Hence, potential but-not-yet-actualized threats, such as those that emanate from new laws or regulatory pronouncements, are unlikely to be considered, which leads to porous risk management efforts. Emerging regulatory compliance (for example, new US SEC rules addressing accountability of executives) and environmental (for example, changing carbon emission standards) or fiduciary (for example, recent adaption of the Volcker Rule in the United States) matters are examples of potential but-not-yet-actualized threats that

could have a potentially significant impact on business, but may not receive adequate consideration within the realm of retrospective risk management efforts.

In order to ensure a more complete treatment of threats confronting directors and officers of business organizations, organizational risk management efforts need to address the interplay between the notions of 'corporate governance' and 'stakeholder ecosystems', while also reinterpreting the notion of 'risk' in the broader context of 'threats' (see Figure 3), which means expressly addressing defined liabilities, estimable risks and non-estimable uncertainties. Last, it is crucial to not lose sight of the need to balance the demands of the duty of care and the protections of the business judgment rule: The former obligates organizational managers to act in good faith, while also exhibiting the fundamental due care in relation to the company's interactions with individual stakeholders (Lees, 1981; Kross and Suk, 2012), while the latter grants managers relatively broad decision-making immunity, so long as their actions are guided by the best interest of the company and do not violate applicable standards or regulations (Greenfield, 2006; Radin *et al*, 2009; Nichols, 2012).

Executive threats

To start, it is important to acknowledge that each of the earlier discussed seven distinct constituent groups of public business organizations – shareholders, regulators, customers, creditors, employees, suppliers and competitors – have somewhat different expectations of corporate managers. The constituent group-specific differences are borne out of interactions among the three shaping forces (political, judicial and market), the business judgment rule and the duty of care. Executive actions that give rise to potentially adverse events are those that fall *within* the realm of the duty of care-derived expectations and *outside* of the business judgment rule-protected behaviors, all in the context of the norm-shaping forces-influenced evaluations (by individual stakeholder groups).

As suggested by the interaction between the business judgment rule and the duty of care, officers and directors of business organizations are expected to actively engage in the running of the company, exercise control over actions of their subordinates, and comply with all applicable legal and other requirements (Radin *et al*, 2009; Nichols, 2012). Considering those general expectations in the context of the upside versus downside dichotomy outlined earlier, five broad categories of the underlying causes of executive threat emerge: (1) illegal behaviors, (2) inadequate controls and (3) negligence, all of which reflect the downside dimension of executive threat, as well as (4) ineffective decisioning and (5) social responsibility, which capture the upside dimension of executive threat. When looked at from the standpoint of systems theory

(Von Bertalanffy, 1968; Luhmann, 1996), which offers insights into the mechanics of inputs, processes and outputs, these three broad causes can be further examined within the context of outcomes and the ultimate consequences, ultimately yielding a more complete accounting and understanding of the totality of executive threats.

Causes of executive threats

Given that managerial behavior represents reasoned choices it is appropriate to examine the underlying root causes of those actions; in terms of tools, the theory of reasoned action (Fishbein and Ajzen, 1975; Ajzen and Fishbein, 1980) offers the best evaluative framework. It posits that observable behavioral outcomes can be seen as products of two key sets of unobservable causes: (1) attitudes (toward a particular behavior) and (2) subjective norms (Fishbein and Ajzen, 1975; Ajzen and Fishbein, 1980; Sheppard *et al*, 1988; Ajzen, 1991; Hale *et al*, 2002; Miller, 2005). As elucidated by Fishbein and Ajzen (1975), Ajzen and Fishbein (1980) and Ajzen (1991), attitude is a function of beliefs about the likely consequences of engaging in a particular behavior, in addition to one's evaluation of consequences of that behavior. Subjective norms, on the other hand, can be conceptualized as products of a combination of perceived expectations along with intentions to comply with these expectations (Fishbein and Ajzen, 1975). Hence, it follows that voluntary actions of directors and officers of business organizations can be seen as consequences of their attitudes toward those behaviors and anticipated reactions of relevant 'others', which in the context of executive threats are the individual stakeholder groups.

Illegal behaviors, the first of the three categories of the downside aspect of managerial responsibility, encompasses actions that are directly attributable to organizational leaders *and* fall outside of the legislatively or regulatorily prescribed behavioral norms or limits (Bilimoria, 1995; Karpoff *et al*, 2008). Examples include violations of securities laws (for example, insider trading), deception (for example, inaccurate public disclosures) or dereliction of duty (for example, failure to act). As illegal behaviors are defined by explicit and binding rules that are in force at a particular point in time, their violations can result in personal liability, to the degree to which there is evidence of willful misconduct on the part of individual executives (Karpoff *et al*, 2008).

Inadequate controls, the second category of causes comprising the downside dimension of managerial responsibility, encompass the failure to organize, restrain and direct the actions of others; in short, they can be construed as a failure to lead and/or supervise (Lumpkin, 2008). They emanate most directly from the duty of care, or an obligation placed upon directors and officers to act with attention, caution and prudence while managing the affairs of the corporate entity. Examples of inadequate managerial control include allowing

prohibited employment practices or failure to provide adequate fiduciary oversight. Similar to illegal behaviors, inadequate control is a manifestation of management's failure to adhere to applicable laws and regulations; however, unlike illegal behaviors that encompass direct action, inadequate control is a reflection of failure to supervise, which translates into lower likelihood of personal liability.

Negligence, the third and final category comprising the downside dimension, covers product and service liability; it is a manifestation of management's failure to exercise adequate due diligence over product design and/or service delivery mechanisms and outcomes (Green, 2015). The thrust of this aspect of the downside dimension of executive threat is (in common law jurisdictions, such as the United States or the United Kingdom) on judicial decisions combining relevant legal precedence with emerging evidentiary and scientific evidence to define slowly but continuously evolving liability standards. Examples include product liability suits, such as those targeting companies that used asbestos, or medical malpractice suits alleging harmful or otherwise faulty medical treatments.

Turning to the upside dimension of executive threat, the first of the two categories is ineffective decisioning, which is a manifestation of the economic efficacy of management's strategic planning, as measured by the company's financial returns, as measured by ROI and ROE[15] (McPhee, 2014). It is most directly impacted by a myriad of market forces such as demand or competitive pressures; however, the earlier discussed interplay between the business judgment rule and the duty of care also exerts a strong, albeit indirect, impact. Corporate managers are granted a considerable degree of decisioning leeway, so long as they act in good faith (Greenfield, 2006; Radin *et al*, 2009; Nichols, 2012); that said, what amounts to a relative decision-making immunity should not be interpreted as absolute impunity, as acting with disregard for pertinent information, such as emerging market trends or competitive developments, can be construed as a violation of duty of care (Branson, 1993; Colley, 2003).

The second of the two categories comprising the upside dimension of executive threat, societal inattentiveness, is a relative 'newcomer' to risk management. Conceptually, it can be seen as a result of growing assertiveness of consumers taking action to compel business organizations to embrace emerging societal norms and expectations regarding the broadly defined 'good corporate citizenship' (Noe and Rebello, 1995; Hollenbeck and Zinkhan, 2006; Glickman, 2009). Stakeholder activism as such is not new – shareholder activism, for instance, dates back to the early 1900s,[16] but wide-scale consumer activism is a relatively recent phenomenon. In fact, it could be argued that it was the growing societal interconnectedness fueled by the rapid spread of communication technologies and platforms that effectively transformed what was earlier a handful of isolated cases into a recognizable and growing force. Hence, it stands to reason that the impact – and thus the potential threat – of consumer activism is likely to become far more pronounced in the future.

Table 1: Executive threats: Causes, outcomes and consequences

Cause	*Outcome*	*Consequence*
Upside risk		
Ineffective decisioning	Inferior strategic choices	Economic underperformance
Societal inattentiveness	Socially unsound choices	Adverse consumer activism
Downside risk		
Improper behavior	Regulatory violations	Litigation – securities
	Dereliction of duty	Litigation – derivative
	Deception	Regulatory investigation
Inadequate control	Regulatory non-compliance	Regulatory investigation
	Employment practices	Regulatory investigation
	Fiduciary oversight	Litigation – fiduciary
	Product/service delivery	Litigation – negligence or malpractice
	Business practices	Regulatory investigation
	Supplier non-performance	Litigation – contract
	Credit non-compliance	Default
Negligence	Product liability	Litigation – tort
	Service liability	Litigation – malpractice

Potential consequences

Consequences of executive missteps can be considered from the standpoint of immediate and near-term effects, or longer-term after effects. While the first two lend themselves to descriptive classification because of being fairly consistent across companies, the longer-term after effects are, to a large degree, shaped by situational and organization-specific factors, making them difficult to generalize. Thus, only the former are expressly considered here.

Immediate and near-term aftermaths of executive missteps can be grouped into five distinct categories: (1) regulatory investigations, (2) litigation, (3) default, (4) economic underperformance and (5) adverse social activism. Conceptually, the first two categories – regulatory and legal actions – may, under certain conditions discussed later, arise out of the same set of precipitating factors (Carter, 2001; Karpoff *et al*, 2008; Loughrey, 2013). The remaining three categories – default, economic underperformance and adverse societal activism – arise out of different sets of stakeholder actions and thus are largely independent of one another (Sametz, 1991; Powell, 2007). A summary view of causes, outcomes and consequences of key risk-precipitating actions of directors and officers of business organizations is shown in Table 1; a more detailed discussion of each of the four types of consequences follows.

Litigation

Outside of a handful of isolated cases of particularly egregious misconduct,[17] cases asserting executive misconduct fall under a broad umbrella of civil law,

which deals with alleged offenses against private individuals (Branson, 1993; MacAvoy and Millstein, 2003; Debenham, 2006). It is instructive to note that the term ‘private individuals’ is not meant to denote individual persons only – recalling that a corporation is recognized as an independent legal entity (hence, legally, it is an individual (Pickering, 1968)), the definition of ‘private individuals’ encompasses all legal entities, which includes persons, businesses and other entities (O’Shaughnessy, 1966; Emanuel, 2005; Palmiter, 2009).

As a part of a broader legal system, civil law encompasses three distinct categories: statutory, common and administrative (Greenfield, 2006). The first of these three categories – statutory – comprises laws created by federal or state legislations; the second – common – represents a body of applicable judicial decisions; the third – administrative[18] – embodies rules created by executive agencies and regulatory bodies. Historically, statutory laws were the main source of executive threats primarily because the bulk of legal requirements and constraints emanate directly from specific legal statutes – for instance, securities litigation most commonly arises out of alleged violations of the Securities Act of 1933 (which deals with the initial public offering of securities) or the Securities Exchange Act of 1934 (governing trading of existing securities), while workplace discrimination claims tend to allege violations of the Civil Rights Act of 1964, the Age Discrimination in Employment Act of 1967 or the Equal Opportunity Act of 1972.

Regulatory actions

In addition to legislative acts, numerous aspects of business are policed by regulatory agencies and commissions, which operate within a broader context of administrative law (Congressional Research Service, 2003; Cavazos, 2007). At the most general level, the role of regulatory bodies[19] is twofold: (1) to translate legislative acts into operationally clear rules and (2) to provide enforcement of statutory provisions. Typically, regulatory bodies are armed with a fair amount of penal power, which includes the so-called ‘cease and desist’ orders and the ability to levy monetary penalties (Custos, 2006; Morris, Grippo and Barsky, 2012). Beyond the administrative remedies, regulatory agencies can pursue legal action against individual business entities (Debenham, 2006); hence, as noted earlier, it is possible for regulatory and legal actions to emanate from a single set of underlying causes.

In general, the US federal regulatory agencies rely on a two-step enforcement process. The first step is to conduct administrative proceedings, which in itself can entail multiple steps (for instance, the Securities and Exchange Commission tends to follow a three-step investigatory escalation process: Matter under Inquiry → Investigation → Formal Order of Investigation; it is worth noting that under certain circumstances the first step of the process may be omitted), including administrative court proceedings. The second step usually entails litigation – more specifically, matters that cannot be satisfactorily resolved

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within the confines of administrative proceedings may then be litigated in federal courts (Congressional Research Service, 2003).

Default

According to modern financial theory, the optimal financial structure for a business organization entails a combination of debt and equity financing (Markowitz, 1952; Modigliani and Miller, 1958; Etro, 2010; Baker and Martin, 2011), which aims to take the maximum advantage of the firm's borrowing costs and its marginal tax rate. In keeping with that widely accepted philosophy, on average about 70–80 per cent of all US public companies carry at least some long-term debt,[20] which in turn creates the possibility of default. In the context of companies' financial obligations, default occurs when a company fails to meet its legal obligations specified in the debt contract, such as making a scheduled payment (Lumpkin, 2008; Baker and Martin, 2011). Default carries multiple and cascading consequences: Damage to the company's credit rating will typically trigger rise in the cost of borrowing, which in turn will likely adversely impact the firm's operational performance and competitiveness.

A core part of organizational management, borrowing decisions are made by executive management, subject to the approval of the board of directors; hence, it follows that defaulting on a firm's financial obligations is clearly a manifestation of inadequate control on the part of organizational leadership (Kim and Nofsinger, 2004; McNulty *et al*, 2011). It is important to note that the definition of default extends beyond non-repayment, as it also includes violating any of the terms of the debt agreement, which points to a couple of somewhat tacit aspects of executive responsibility: (1) consenting to hard-to-adhere-to terms and (2) contract non-performance (Sametz, 1991; Radin *et al*, 2009). Although in many regards these are two ends of the same continuum, each points to a somewhat different alternative: Either insist on more manageable terms, or ensure compliance with the agreed-to ones.

Economic underperformance

The preceding discussion of the three types of consequences of managerial actions – litigation, regulatory actions and financial default – represents the downside aspects of executive threat; economic underperformance, on the other hand, is the first of the two manifestations of the upside dimension of executive threat. Defined as outcome that is below an applicable norm, where 'norm' is an average of peer reference points, economic underperformance can be taken as possible evidence of ineffective strategic decisioning. Although results of business performance can be measured in a myriad of ways, ROI and ROE are the two most frequently used metrics and are also most meaningful from the standpoint of risk management (Tosi and Gomez-mejia, 1989; Datar *et al*, 2001).

The first of the two measures of performance, ROI, is simply a ratio of revenue to expenses (Phillips *et al*, 2012); from the standpoint of shareholders, however, it

can be thought of as a product of two somewhat distinct components: (1) dividend payments and (2) share price appreciation. The former, which represents a share of the firm's profits, is realized on an ongoing basis (typically annually), while the latter can only be realized upon the sale of the security. Hence, it follows that ROI-based performance evaluation can ultimately reflect either sub-par dividend payments or sub-par equity appreciation, or a combination of the two. Last, ROI can be seen as a continuous measure of investment performance, as, though dividend payments are episodic, share price is continuously variable, which allows for cumulative as well as point-in-time assessments.

The second of the two measures of performance, ROE, captures the corporation's profitability by relating net income by shareholder's equity (Taitelbaum, 1996; Wang, 2013). In contrast to ROI, strong ROE yields no immediate benefit to shareholders – however, when the company's ROE is high and the company's earnings are reinvested in the business, it will generally result in an attractive growth rate. Hence, in a sense, ROE complements ROI – the former is a reflection of the likely future benefit of ownership (of the company's stock), while the latter is a reflection of the current benefit of ownership. Thus, albeit for different reasons, ROE also directly impacts the security's trading volume and, by extension, executive threat.

From the standpoint of directors and officers of business organizations, the performance of companies they govern is perhaps the single most visible and important manifestation of the efficacy of their actions (Korine and Gomez, 2014; McPhee, 2014). At the same time, the potential threat of adverse stakeholder action triggered by economic underperformance is perhaps the least understood of all executive threats, primarily because of hard-to-ascertain causality underpinning those actions. The earlier noted protection of the business judgment rule means that, assuming proper discharge of their duty of care obligations, strategic choices of business managers are generally not subject to regulatory or judicial scrutiny (Greenfield, 2006; Radin *et al*, 2009; Nichols, 2012), which means an absence of easily discernable signs of stakeholder disapproval, such as regulatory inquiries or shareholder litigation. At the same time, the common separation of management and ownership highlighted by the notion of agency dilemma (Eisenhardt, 1989; Parks and Conlon, 1995; Stroh *et al*, 1996; Pepper and Gore, 2013) suggests the possibility of a misalignment of goals of the two groups, which in turn can lead to informal stakeholder actions, ranging from simple divestment to proxy fights. Though perhaps lacking the specificity of their downside counterparts, threats that emanate from sub-par performance are nonetheless quite distinct and tangible: The loss of investors' confidence-precipitated divestment can have a material impact on the company's valuation (and thus incentivize part of business managers' compensation), while a proxy fight might lead to the ousting of the board of directors and executive leadership.

Adverse social activism

The second manifestation of the upside dimension of executive threat is adverse consumer activism, which is typically a consequence of societal inattentiveness of business organizations. As noted earlier, when looked at from an enterprise perspective, business organizations can be characterized as social institutions operated for the benefit of multiple stakeholders, including customers and the public at large (Purdy, 1983; Hendrikson and Breda, 1992). Naturally arising from that conception is the notion of corporate social responsibility, broadly defined as the integration of a company's business operations and societal values, in a way that amalgamates the interests of all of the company's stakeholders, including communities in which it operates, with its policies and actions (Carroll, 1999; Thauer, 2014; Pedersen, 2015). Doing the 'right thing' can have numerous manifestations, such as environmental sustainability, employee diversity, corporate philanthropy or local production/sourcing; as regards benefits, doing the 'right thing' may also lead to doing better (Bhattacharya and Sen, 2004), in addition to which it can assist decision makers in resolving managerial dilemmas (Thauer, 2014). Conversely, not doing the 'right thing' can lead to significantly adverse consequences including negative publicity or various forms of stakeholder retributions, such as consumer boycotts (Hollenbeck and Zinkhan, 2006; Van Cranenburgh *et al*, 2013).

Although consumer activism is a decades-old phenomenon,[21] broadly defined adverse social activism has rarely been explicitly recognized by corporate risk managers as a stand-alone threat, one that needs to be responded to in essentially the same manner as the more established ones. Not doing so can have serious consequences: While the rapidly growing social interconnectedness has been a great enabler of initiating and growing large-scale consumer campaigns, the vastly expanded informational capabilities and domains available to organizations made staying informed considerably easier. Recalling the corporate management's duty of care discussed earlier, if a threat is identifiable and information pertaining to it available, inaction on the part of directors and officers could be interpreted as abdication of their fundamental responsibilities to stay informed and to act.

A Conceptual Model of the Structure of the Executive Threat Ecosystem

The preceding discussion suggests a somewhat complex picture of the structure of executive threat, which is graphically depicted in Figure 4. Cast in the context of the notion of ecosystem, the model explicitly captures the three norm-shaping forces, while also implicitly accounting for the seven stakeholder groups, both depicted earlier in Figure 2. Furthermore, the Structure of Executive Threat model also depicts the five general causes of adverse events, along with specific outcomes, summarized earlier in Table 2. Last, the

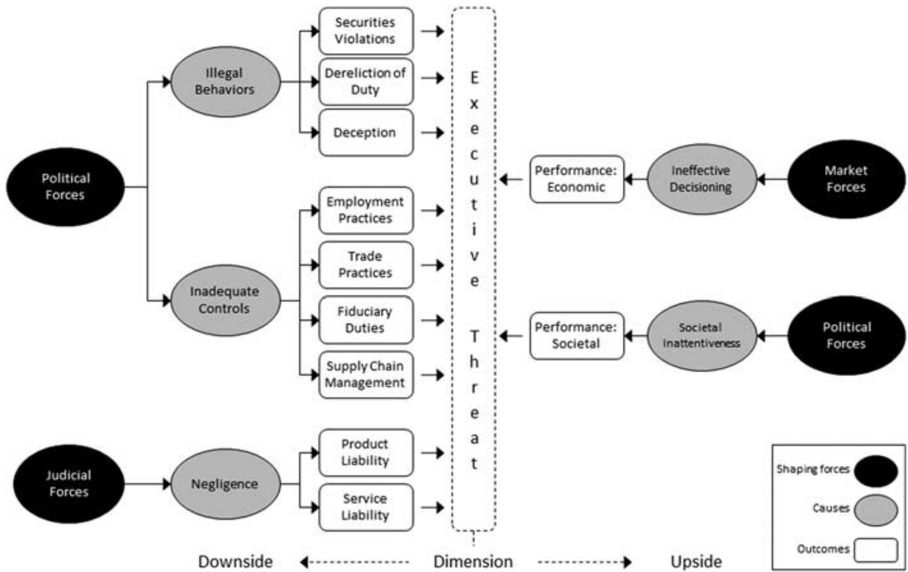

Figure 4: The structure of Executive Threat model.

Table 2: Major US federal regulatory agencies

Agency name	*Scope of oversight*
Consumer Product Safety Commission (CPSC)	Federal safety standards
Environmental Protection Agency (EPA)	Pollution standards
Equal Employment Opportunity Commission (EEOC)	Title VII of the Civil Rights Act of 1964
Federal Aviation Administration (FAA)	Air transportation safety
Federal Communications Commission (FCC)	Interstate and foreign electronic communications
Federal Deposit Insurance Corporation (FDIC)	Mergers; banking practices
Federal Reserve System (FED)	Bank regulation
Federal Trade Commission (FTC)	Free and fair competition
Food and Drug Administration (FDA)	Food purity; drug testing and safety;
Interstate Commerce Commission (ICC)	Interstate transportation
National Labor Relations Board (NLRB)	Unfair labor practices
Nuclear Regulatory Commission (NRC)	Non-military nuclear facilities
Occupational Safety and Health Administration (OSHA)	Working conditions and worker safety standards
Securities and Exchange Commission (SEC)	Buying and selling of securities

conceptualization expressly differentiates between the downside and the upside threat dimensions, with the goal of drawing attention to the theoretical and practical distinctiveness of these two distinct sets of categories.

Overall, the Structure of Executive Threat model delineates 11 distinct operating areas that can directly give rise to adverse events, as seen from the point of view of directors and officers of business organizations. Three of those

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areas – securities (law) violations, dereliction of duty and deception – represent distinct types of illegal behaviors arising out of violations of applicable legislative acts or regulatory pronouncements. Four other areas – employment and trade practices, fiduciary duties and supply chain management – embody the organizational management's failure to institute and/or exercise adequate controls over specific aspects of organizations' operations. Together, those seven distinct outcomes can be thought of as 'tangible' manifestations of how socio-political forces shape the regulatory non-compliance aspect of executive threat.

Judicial forces-shaped product and service liability round off the list of components of the downside dimension of executive threat. Those two manifestations of potential negligence are distinct not only because they can be seen as consequences of 'what' the organization produces, rather than 'how' it operates, but also because of the emergent nature of case law. Unlike the relatively slow and foreseeably changing statutory laws, new case law may evolve fairly rapidly, which means that the standard of negligence is itself prone to more rapid and unexpected change.

Last, the Structure of Executive Threat model also captures the upside dimension of executive threat, which takes the form of ineffective decisioning or societal inattentiveness. The former, driven by market forces, encapsulates the economic efficacy of organizational managers' strategic choices, while the latter, driven by political forces, captures the degree to which the organization's strategies and operations are integrated with societal values. In many regards, this is the most complex aspect of executive threat as it reflects the interplay between the protection extended to executive decision makers by the business judgment rule and the demands placed on them by the duty of care, in addition to the more tacit pressures exerted by competitive and societal forces.

Implications for research and practice

The goal of the research summarized here was to offer the first step toward the development of conceptual foundations of the structure and root causes of threats confronting directors and officers of business organizations. Cast in the context of ecosystem, a broad domain of *executive threat* is introduced as an extension of narrower, practice-framed and historical developments-focused notions of 'executive risk' and 'executive liability'. In addition to offering an explicit delineation of the underlying sources of hazards confronting corporate managers, the new conceptualization extends the scope of those hazards to not-yet-materialized, potential dangers emanating from emerging regulations, as well as changing socio-economic-political trends and attitudes. It is hoped that the broadly scoped, descriptive research outlined in this article will compel researchers to systematically address the numerous dimensions comprising the domain of executive threat, subjecting the conceptually derived associations to empirical scrutiny and offering new

perspectives to further broaden and deepen the current understanding of this important aspect of business risk.

This article is also intended to serve as a call to action for practitioners, to broaden their conception of what constitutes executive threats. The combination of seemingly ever greater economic volatility and rapidly evolving regulatory realities suggests that to be effective, the management of risk has to go beyond a mere extrapolation of historical trends – simply put, tomorrow's danger is more than just a likely repetition of yesterday's events. To be sure, the already-known risks are indeed important and need to be properly addressed; at the same time, it is also important to recognize – and to act on that knowledge – that not-yet-known dangers may materialize tomorrow, and sound risk management practices need to take requisite anticipatory steps. The pursuit of organizational resilience, which should be the goal of risk management, demands no less.

Notes

1 The exact definition of 'executive officer' may vary across countries (for example, in the United States, the top executive officer is typically known as the Chief Executive Officer, whereas in the United Kingdom the title of Managing Director is more commonly used) as well as states (in the United States, since US corporate law is rooted in state law). Furthermore, the line of demarcation separating executive officers from other corporate managers may also vary across jurisdictions, as some base the distinction on job titles (for example, only those referred to as 'chief', such as Chief Executive or Chief Financial Officers), while others use compensation (for example, California defines 'executive officers' as the top five most highly compensated corporate officers).

2 Though manifestly bearing the same name as the public/political leadership selection process, the process of 'electing' corporate directors is considerably less democratic for a number of reasons, not the least of which is that shareholders rarely, if ever, have adequate informational basis for voting for or against individual candidates. In terms of procedure, directors are usually nominated by the executive management and then typically voted on during the annual shareholder meeting; considering that relatively few shareholders attend those meetings, in practice, corporate directors are effectively selected by firms' executive managers and legitimized by proxy votes (or the holders of those votes, often fund managers).

3 Most notably, the Securities Act of 1933 and the Securities Exchange Act of 1934.

4 Estimate based on analyses of 2010–2015 annual public filings as reported by Standard & Poor's Compustat database.

5 Although that is beginning to change as some other countries, such as the United Kingdom, Germany and France, have all taken limited steps in that direction, at the time of this research the United States is the only developed country that allows large-scale – that is, class action – shareholder suits.

6 http://www.sec.gov/spotlight/optionsbackdating.htm

7 Option backdating is the act of granting an option to purchase a security that is dated before the date of the grant itself, which means that the exercise price of the granted option can be set at a lower price than that of the company's stock at the granting date, thus ensuring that the granted option is of value to the holder. The concept, first put

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forth in 2005 by Erik Lie, a researcher at the University of Iowa, in a paper titled 'On the Timing of CEO Stock Option Awards' (*Management Science*, Vol. 51(5), pp. 802–812), ultimately led to about 2 dozen shareholder class action suits.

8 It is worth noting that representatives of individual states drafted the Uniform Business Corporations Act in 1928 with the goal of creating a country-wide set of standards, though only three states adopted it. In 1950, the American Bar Association drafted the Model Business Corporation Act, which has been revised numerous times, most recently in 2005, with the majority of states adopting some or all of the Model Act. The State of Delaware, where the majority of large US corporations are incorporated, continues to be the single most important source of corporate regulations.

9 For a full list, see www.usa.gov/directory/federal/index.shtml

10 Technically, the legislative, executive and judicial branches of the US government are not independent of one another because of a system of checks and balances set up by the US Constitution; however, in the context used in this research, the two branches considered here (legislative and judicial) produce expectation-shaping outcomes in a manner that is essentially independent.

11 As reported for an industry research firm ISS, the all-time largest settlement stands as the one by Enron (2010) at $7.42 billion, followed by (all figures in $ billion) WorldCom (2012) at $6.194, Cendant Corp. (2000) at $3.319, Tyco International (2007) at $3.2, AOL Time Warner (2006) at $2.5, Bank of America (2013) at $2.425, Nortel Networks (2006) at $1.443, Royal Ahold (2006) at $1.143, Nortel Networks (2006 – separate from above) at $1.074, and McKesson HBOC (2008) at $1.052.

12 Gimbel v. Signal Cos, 316 A2d 599, 608 (Del. Ch. 1974). The business judgment rule originated in a 1945 shareholder action (Otis & Co. v. Pennsylvania R. Co., 61 F. Supp. 905 (D.C. Pa. 1945)), in which the plaintiff alleged that corporate directors failed to obtain the best price available in the sale of securities by dealing with only one investment house.

13 Corporate directors can – and typically do – establish a defense of 'due diligence', which is that he or she made a good faith effort to ascertain the correctness of the reported information. Whether or not corporate directors did enough due diligence to meet the good faith effort standard is typically determined by circumstances of individual cases – it is important to note, however, that the securities laws make no distinction between cases where management has committed deliberate fraud (that is, took affirmative steps to hide the truth) and cases where reported information merely contains misstatements that could have been discovered in the course of due diligence.

14 Although commonly referred to as risk transfer, commercial insurance is more correctly described as a post-event compensatory mechanism, as purchase of an insurance policy does not change the likelihood or the severity of an adverse event.

15 ROI, or *return on investment*, is a measure of the profitability of an investment, computed by dividing revenue by expenses; ROE, or *return on equity*, is a measure of a corporation's profitability, computed by dividing net income by shareholder's equity.

16 One of the earliest known examples of shareholder activism dates back to the early 1900s, when Henry Ford chose to cancel a special dividend to instead spend those funds on advancing social causes; dissident shareholders sued and won, forcing the company to reinstate the dividend.

17 Exemplified by several former executives of Tyco, Enron, WorldCom or Adelphia, whose actions precipitated criminal proceedings brought against them by federal prosecutors (for clarity – criminal charges entail possible imprisonment, while civil charges do not; in general, the basic distinction between a *criminal* and a *civil* offense is

that the former pertains to transgressions against public order or people as a whole, while the latter is an offense against private individuals).

18 For clarity, I should point out that administrative law only has legal force because of enabling statutes enacted by federal or state legislatures, which is to say that the former could be viewed as a specific manifestation of the latter. That said, its importance should not be underestimated – in an average year, the US Congress enacts about 300 laws, while federal administrative agencies, as a whole, write about 10 000 individual regulations.

19 The difference between regulatory commissions and agencies is not always clear – in general, in the United States commissions are created by Congress to oversee executive agencies (that is, those created by the executive branch of the government that operate independently of the legislature (as a part of the system of checks and balances)); regulatory agencies, on the other hand, tend to be a part of the executive branch, but tend to derive their rule-making powers from specific legal statutes.

20 Based on the analysis of annual filings (US SEC form 10-K) by publicly traded companies.

21 Although it is difficult to pinpoint its exact beginning, the publication of Rachel Carson's book *Silent Spring* in 1962 (which ultimately led to a 1973 ban on most uses of the chemical DDT) is considered by many to mark the beginning of modern consumer activism.

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