

Fall 2000

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Recommended Citation

DeNisi, Angelo and Elaydi, Raed (2000) "Which Came First, The Irrational Consumer or The Irrational Corporation?," *Roger Williams University Law Review*: Vol. 6: Iss. 1, Article 3.

Available at: http://docs.rwu.edu/rwu_LR/vol6/iss1/3

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Which Came First, The Irrational Consumer or The Irrational Corporation?

Angelo DeNisi* & Raed Elaydi**

*It is the mission of the twentieth century to elucidate the irrational.*¹

INTRODUCTION

Most people are aware of the fact that, in recent years, there have been a number of exceedingly large settlements that have been imposed in product-liability cases.² Although many such cases involve serious harm to the injured parties, as well as evidence of foreknowledge of the potential for that harm, many other cases do not entail harm or egregious actions. Yet, juries have been willing to make huge awards in cases where the nature of the problem, and/or the nature of the damages, simply do not seem to be that serious. Although many of these judgments have been overturned on subsequent appeal,³ the publicity surrounding some of these awards has led many individuals, on all sides of the issue, to ask what can be done?

One group of individuals, primarily in the legal arena, has attempted to use economic theory to limit large settlements. They suggest that the court should adopt an economically rational approach to dealing with these cases. This group, which has been

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1. Maurice Merleau-Ponty et al., *Texts and Dialogues* (1992).

2. See Ted Evanoff, *Jury Hits GM with Record Judgment; \$4.9 Billion Awarded; Lawyers Say Automakers Knew of Gas Tank Problem but Didn't Fix It*, Indianapolis Star, July 10, 1999, at A1.

3. See *id.*

labeled the "law and economics movement," suggests that companies should not be held liable because consumer decisions are based on price, and the level of risk the product possesses is embedded in the price.⁴ The law and economics movement assumes that consumers act rationally (in an economic sense), and so are willing to accept a certain amount of risk in return for lower prices.⁵ If consumers wanted to avoid *ALL* risk, they would simply be willing to pay more for a product.⁶ Thus, consumers would largely be held responsible for their own actions, and the potential liability for the company would be greatly reduced.

Advocates of this approach make two assumptions regarding the consumer. First, it is assumed that consumers make rational decisions in their purchases.⁷ Consumers do not purchase items out of impulse or depending on their mood or affective state—this movement does not distinguish a consumer going to a grocery store famished or full. Secondly, these advocates assume that people are well-informed of the products that they are purchasing, giving the consumer an ability to make rational decisions.⁸ Therefore, when consumers pay less, they know they are paying less for riskier products because the product is inherently more dangerous than other competing products, which cost more. For example, some consumers might be willing to pay more for a safer automobile such as a Volvo, but not all consumers will be willing to pay this premium. Others are either unable or unwilling to pay a premium and so knowingly take on the risk of purchasing a Yugo. Therefore, the law and economics theory states that the negative price of risk is embedded in the cost of the product. The consumer in the law and economics approach knows and understands the benefits of owning a risky car, but realizes that these risks are worth taking in exchange for a lower price.⁹ The consumer, in this view, also believes that driving an unsafe car is better than other alterna-

4. See generally Christine Jolls et al., *A Behavioral Approach to Law and Economics*, 50 Stan. L. Rev. 1471 (1998) (challenging classical law and economics' views of the consumer); Mark Tushnet, *Idols of the Right: The "Law and Economics" Movement*, Dissent, 1993, at 475 (discussing the growth of the law and economics movement and its effects on the legal community).

5. See Jolls et al., *supra* note 4, at 1541-45.

6. See *id.*

7. See *id.*

8. See *id.*

9. See *id.*

tives, such as walking or taking the subway, each of which has its own risks.

How does a consumer become well informed? A consumer becomes well informed by gaining information about the product and then rationally assessing its level of risk.¹⁰ To accomplish this the consumer would most likely read the label on the product, or a brochure of its safety features, or maybe even a *Consumer Digest* article. But what if the consumer is at a low level of literacy? The numbers are staggering: 21% to 23% of adults—or some 40 to 44 million of the 191 million in this country—demonstrate skills in the lowest level of prose, document and quantitative proficiencies (Level 1).¹¹ Individuals included in Level 1 are diverse, but display limited skills; some are unable to total an entry on a deposit slip, locate the time and place of a meeting on a form or identify a piece of specific information in a brief news article.¹²

But literacy problems are only one of the more obvious barriers to consumers making truly informed decisions. We will argue that the assumptions upon which the law and economics theory are based are simply not accurate, and a court's reliance on the theory is not possible because it lacks validity. Specifically, we will argue that consumers do NOT make rational decisions because they are not well-informed about the potential risks they face, and because they are biased in the way they process the information they do possess. Although both of these issues are critical for understanding how consumers make decisions about risk, our discussion will focus primarily upon the first issue because others are better able to address the second issue.

Stated simply, we believe that the flow of information in organizations, about the potential riskiness of products is very limited. As a result, consumers do not have the information they need to make a truly rational decision. Although one might argue that organizations are purposefully working to keep any such information

10. *See id.*

11. *See* Irwin S. Kirsch et al., *Adult Literacy in America: A First Look at the Results of the National Adult Literacy Survey*, National Center for Education Statistics (Sept. 1993). Surveys were conducted during 1992 with 13,600 individuals age 16 and older, selected randomly, plus additional surveys for selected groups. Total sample size was over 26,000. Results were reported in terms of levels [Level 1 is lowest; Level 5 is highest] for three literacy scales: prose, document and quantitative.

12. *See id.*

from the consumer, and so are acting rationally, we believe that the processes in operation are much more complex than that. In our discussion, we will draw upon several bodies of research from organizational behavior and management, to argue that, whether or not organizations intend to hide potential risks from consumers, there are several processes operating in most organizations that will work to severely limit the information available. Unfortunately, these processes will also result in the organization itself making less than rational decisions because the decision-makers in the organization will also fail to have all the information they need.

Specifically, we will argue that group decision processes, such as groupthink, will make it less likely that even the decision-makers themselves are fully informed about potential risks. Next, we will suggest that even when decision-makers do learn about problems, their reactions will not always be as one might expect because of a phenomenon known as escalation of commitment. We will then discuss the role of individuals who can potentially make these risks public, but are often restrained in their attempts to do so (whistleblowers). Finally, we will discuss how organizations use "accounts" to put a positive spin on any problems that have been identified and have been made public. Thus, in the end, we will argue that corporations control the information flow within the organization and to the consumer, causing the employees and the consumer to be uninformed. As a result, there can be no rational consumer, and so the law and economics approach to dealing with product liability cases is of questionable value.

We will begin our discussion with a brief consideration of biases and problems that relate to individual decision-making. As noted above, this is not the primary focus of our discussion, but we recognize that, even if consumers had all the relevant information available to them, there is good reason to believe that they would not make economically rational decisions. We leave it to others, however, elsewhere in this volume, to discuss these issues in more detail. But, we believe that it is important to open our discussion with the recognition of those factors that limit the applicability of economic assumptions regarding individual decisions.

INDIVIDUAL CONSUMER DECISION-MAKING

Human beings are NOT passive processors of information. Any individual who makes decisions brings his or her own beliefs, biases and other idiosyncrasies to each decision. Furthermore, individuals are limited in their ability to process information, and tend to use the information that is most easily accessible rather than seeking out new information. If a decision-maker does not have, or seek all the relevant information, he or she cannot make a truly rational decision. It is true that a decision can be rational within the bounds of the information used, but this is often not the most rational decision that can be made. There are many reasons to believe that decision-makers do not use all the information that they need, and these reasons are also viewed as "threats" to rational decision-making. Although these issues are not the focus of the present discussion and, in fact, they are discussed in much more detail elsewhere, it is helpful to briefly review some of the biases that limit the rationality of individual decisions.¹³

Framing and Loss Aversion

When individuals are given choices to make, these choices can be framed either in terms of potential losses or potential gains. But there is a fair body of research¹⁴ to suggest that people's aversion to loss is far greater than their attraction to gain. Therefore, when people are faced with a choice between a sure gain and a risky gain (of greater value), they will generally take the sure thing. But, when people are faced with the choice between a sure loss and a risky loss (of greater value), they will generally take the risky alternative and hope they will lose nothing.¹⁵ Thus, most people prefer a guaranteed payment of \$100 to 50% chance to either win \$200, or win nothing, but, they prefer the 50% chance of *losing* \$200 (or lose nothing), to the certainty of losing \$100. Since the expected values in each case are the same, it is irrational to prefer

13. See generally Amos Tversky & Daniel Kahneman, *The Framing of Decisions and the Psychology of Choice*, 211 *Science* 453 (1981) (discussing the limitation of rationality in decision-making); Paul Slovic et al., *Cognitive Biases and Societal Risk Taking*, *ORI Res. Bull.* 16 (1974) (studying the impact of biases in rational decision-making).

14. See Tversky & Kahneman, *supra* note 13, at 457-58.

15. See *id.* at 454-55.

one outcome to the other in either case.¹⁶ Yet, when the problem is framed in terms of potential losses, people prefer riskier options, and when the problem is framed in terms of potential gains, they prefer more certain options.

Availability Bias

When people are assessing the probabilities of something happening, they base these judgments on the extent to which they can call to mind different outcomes.¹⁷ Therefore, if you were trying to decide whether to start smoking and were worried about cancer, you would be less likely to start smoking (because you would assess the probability of getting cancer as higher) if a close relative recently died of cancer. If no such example is easily available to you, you will underestimate the probability of getting cancer. This ignores the actual probability of getting cancer, and leads to an irrational decision based on your personal experience.

Base Rate Problems

Decision-makers have problems in dealing with base-rate information, especially if they have personal information that contradicts the base-rate information.¹⁸ Let us say that we know that 95% of all first graders are seven years old. But you meet five children in a row who are in the first grade and are eight years old. A sixth first-grader comes along and you have to guess the child's age—you are likely to guess that he or she is also eight years old, even though the odds of the child being seven remain ninety-five in a hundred.

These last two sources of bias recently received some attention in the media, relative to the issue of hormone replacement therapy for women.¹⁹ The medical evidence seemed to suggest that the therapy was effective in reducing the chances of heart disease, and so gained some popularity.²⁰ But then evidence came to light to

16. *See id.*

17. *See* Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, 185 *Science* 1124, 1127 (1974).

18. *See id.*

19. *See* Susan Okie, *New Studies Raise Old Fears: Do the Benefits Outweigh Risk When it Comes to Hormone Replacement Therapy?*, *Detroit News*, Mar. 5, 2000, at A6.

20. *See id.*

suggest that the therapy could increase the chances of certain forms of breast cancer.²¹ This latter finding caused women to turn away from the therapy. But, as noted by several medical experts at the time, for most women, the chances of dying from heart disease were much greater than the chances of dying from breast cancer.²² Thus, the rational decision (for most women anyway) would be to undergo the therapy, but it took the medical community a great deal of time to convince women to make this "rational" choice.

Again, these cognitive biases deserve much greater attention because they severely impair one's ability to make rational decisions. Thus, they call into serious question any assumptions of rationality that might be made. But, one might argue that individuals differ in their susceptibility to these biases, and that, by identifying the potential biases, we can make decision-makers aware of them and so make them easy to avoid. This may or may not be the case, but it may be a point worth discussing. However, in order to make any assumptions about any person being rational in any situation, we must also assume that the person has the necessary information available to him or her and that the decision-maker simply chooses to ignore the information or to use it incorrectly. The remainder of our discussion will raise questions about this second assumption. We believe that consumers, making purchase decisions cannot possibly make rational decisions because the information they need is really not available to them. We will argue that this is due to a number of processes that take place in organizations that restrict the information available to the consumer. We turn, then, to a discussion of ways in which organizations actually work to limit the rationality of consumer decisions.

HOW ORGANIZATIONS LIMIT RATIONALITY

Organizations restrict the flow of unfavorable information to consumers. Thus, consumers cannot possibly make rational decisions because they do not have the information they need to make those decisions. Of course, these consumers might well be unable to make rational decisions because of the biases discussed above,

21. *See id.*

22. *See id.*

but the lack of total information makes the chances of rational decisions even slighter.

Why do organizations work to limit the unfavorable information available to them? The obvious answer is to avoid lawsuits and charges of responsibility. In fact, this is an important part of the process, but it is not the only part. Just as there are biases limiting individual's ability to make rational decisions, there are other "biases" that operate at the organizational level.²³ Some of these make it less likely that *anyone* will learn about problems or acquire negative information, and these biases often operate without anyone really being aware of them. In fact, there is a tendency in organizations to ignore or dismiss unfavorable information.²⁴ This is, in itself, irrational. However, there is a considerable body of evidence which suggests that this is exactly what happens through a number of different mechanisms, which are discussed below.

Groupthink

When groups make decisions, information that is contrary to the general group sentiment is censored. That is, anyone raising an objection to a course of action or even questioning that course of action is usually censored by other members of the group. As a result, the group really does NOT consider all the information available to it, and so makes irrational decisions that are often disastrous. This problem is referred to as "groupthink."²⁵

This phenomenon is most prevalent in groups where there is a high level of cohesiveness (i.e., attraction to remain a part of the group). This cohesiveness tends to be higher when group members are more similar to each other and where the group has enjoyed success in the past.²⁶ It is interesting to note that, although research generally indicates that cohesive groups are mostly (although not always) more productive, the desire to maintain cohesiveness may override the desire to make a rational decision.²⁷ That is, to maintain cohesiveness, individuals must suppress their voice and be a "team player," limiting perceived dilatory dissent.

23. See Irving L. Janis, *Groupthink* 7 (2d ed. 1983).

24. See *id.*

25. See *id.*

26. See *id.* at 245.

27. See *id.* at 245-48.

At the same time, cohesive groups tend to be high on seeking concurrence. Thus, if a group has been successful in the past, they will soon gain a sense of their own invulnerability. Understanding one's limitations in an environment or situation is crucial in assessing a decision. However, if a group feels invulnerable they will overestimate their capabilities and unanimity and enter into an ill-fated course of action. Group members, who respect each other's opinions, come to believe that everyone is in agreement, because no one voices dissension; and when dissension is voiced, the dissenter is often portrayed as disloyal, or his or her concerns are discounted by so-called "mind guards."²⁸

A classic example of groupthink in action occurred during the decisions around the Bay of Pigs Invasion. The comments of some of those who were present are quite telling. Ted Sorensen stated: "No strong voice of opposition was raised in any of the key meetings, and no realistic alternatives were presented."²⁹ Moreover, Arthur Schlesinger stated "Our meetings took place in a curious atmosphere of assumed consensus."³⁰ President Kennedy, several days before the final decision, and still feeling confused by his own judgment and decision-making skills, stated: "we seem now destined to go ahead on a quasi-minimum basis."³¹ All under Kennedy felt it would have been difficult for anyone to voice disagreement and remain a member of the group in good standing.³²

Thus, decisions made by groups of managers in organizations can easily be irrational, as the group becomes victim to groupthink. For example, a group of managers at some organization, discussing the possibility of a potential problem occurring, might not be willing to listen to anyone who says that the exact series of events that might lead to a disaster (such as an actual explosion) is not that uncommon. It is difficult to design a system based on rationality, when the organization in question is, itself, making irrational decisions. But what happens when an organization is faced with the realization that they have made an error, or have followed the wrong course of action? A rational decision-making model would

28. *See id.* at 175.

29. Janis, *supra* note 23, at 38.

30. *Id.*

31. *See id.* at 40.

32. *See id.* at 39.

suggest that, once the realization occurs, the organization will abandon the present course of action and pursue an alternative.³³ Clearly this will be more difficult (and less likely) if the organization has already traveled down the road quite far, and has committed large amounts of resources to a given course of action.

Unfortunately, there is a considerable body of data to suggest that organizations fail to correct mistakes, even when they have *not* already committed large amounts of resources to a course of action.³⁴ In fact, a phenomenon known as "escalation of commitment" suggests that organizations (and individuals) actually commit increasing amounts of resources to failing courses of action.³⁵

Escalation of Commitment

The formal introduction of the concept of escalation of commitment came from Barry Staw when he began describing situations where decision-makers actually increased their level of commitment to a course of action when they discovered that the course was failing.³⁶ Staw drew upon another example from our history, when he described the U.S. decisions to send more troops to Vietnam. He suggested that as the U.S. began a troop build-up, it became clear that it would not be able to easily defeat the North Vietnamese and Vietcong, as had been promised. Rather than admit that the original plan was perhaps wrong, our government responded by sending even more troops to the conflict.³⁷ In fact, we repeated this decision several times, even though, at no point, was there any information to suggest that this course of action was succeeding.³⁸

33. See Tversky & Kahneman, *supra* note 13, at 453.

34. See, e.g., Hillel J. Einhorn, *Expert Measurement and Mechanical Combination*, 7 *Organizational Behav. & Hum. Decision Processes* 86 (1972); Gary J. Gaeth & James Shanteau, *Reducing the Influence of Irrelevant Information on Experienced Decision-Makers*, 33 *Organizational Behav. & Hum. Decision Processes* 263 (1984).

35. See Barry M. Staw & Jerry Ross, *Behavior in Escalation Situations: Antecedents, Prototypes, and Solutions*, 9 *Res. Organizational Behav.* 39 (1987).

36. See Barry M. Staw, *Knee-Deep in the Big Muddy: A Study of Escalating Commitment to Chosen Course of Action*, 16 *Organizational Behav. & Hum. Performance* 27, 27 (1976).

37. See *id.*

38. See *id.*

Consider the following memo sent to Lyndon Johnson by Undersecretary of State George Ball as the early decision to send more troops was being contemplated:

The decision you face now is crucial. Once large numbers of U.S. troops are committed to direct combat they will begin to take heavy casualties in a war they are ill-equipped to fight in a noncooperative if not downright hostile countryside. Once we suffer large casualties, we will have started a well-nigh irreversible process. Our involvement will be so great that we cannot—without national humiliation—stop short of achieving our complete objectives. Of the two possibilities, I think humiliation would be more likely than achievement of our objectives—even after we have paid terrible costs.³⁹

This phenomenon was demonstrated in situations with less dramatic consequences in a number of studies,⁴⁰ and it seems to be quite robust. Notice that we are not suggesting that decision-makers will simply stick with a failing course of action, but that they will actually increase their level of commitment (of resources as well as psychological commitment) to a course of action that is failing.⁴¹ In the present context, we can think about a firm that has discovered that there is a problem with one of its products. Rather than using this newfound information to recall the product and negate future liability, the company hides and denies the problem. No one is supposed to talk about the problem, but someone does and it leaks to the public. It should be clear, at this point, that the company will not be able to keep the problem quiet, and so the logical response would be to confess all and ask for sympathy. But the “preferred” response is to work even harder to deny the problem and/or to keep it quiet. Such a response may not be rational, but it seems to be likely. Given Bill Clinton’s response to leaks about his affair with Monica Lewinsky, escalation of commitment is still alive and well.

But, if this response is not rational, why do so many decision-makers adopt it? Research in escalating commitment has shown that escalation situations are primarily a function of psychological traits such as self-justification.⁴² However, the effect of such traits

39. Barry M. Staw, *The Escalation of Commitment to a Failing Course of Action*, 6 *Acad. Mgmt. Rev.* 577, 577-78 (1981).

40. *See id.* at 578-81.

41. *See Staw & Ross, supra* note 35, at 41.

42. *See Staw, supra* note 39, at 581-83.

on decision-making is also “dependent upon a number of variables which include the situation, the level of commitment, and the cultural norms involved.”⁴³ When there is a strong need for external justification, an administrator will likely save a policy failure by enlarging the commitment of resources. Stiff policy resistance causes the decision-maker to defend her policy because a link is created between the policy and the individual making the policy.⁴⁴ The policy-maker is not only defending the policy but her own character. The administrator will be motivated to protect herself against failure.

Staw used a simulated case where subjects tended to allocate more resources to the declining venture rather than the successful one.⁴⁵ The subjects made the decision to give initial resources to the venture. Once the venture started to fail, the resource allocator based her next decision (to put more resources in the project) on her past decisions.⁴⁶ The argument being that her first decision was based on her own logic and reasoning, and therefore she becomes illogically committed to the venture. This situation tends to develop an irrational escalation of commitment, causing a distribution of more resources to the failing venture.⁴⁷

When “failure is not an option,” as in the case of an administrator whose job is vulnerable, the decision-maker keeps pursuing the objective until the program is terminated or an improbable windfall occurs.⁴⁸ There is a paradox in regards to failure, because maintaining the same course of action is rewarded, while halting the failing and/or harmful endeavor causes the loss of the manager’s livelihood, and so is punished.⁴⁹

Studies have shown that an escalation of commitment also occurs with groups. Rutledge’s study shows that “decision-making management groups are more likely to escalate their commitment to a failing course of action when they are responsible for the origi-

43. Scott W. Geiger et al., *The Impact of Cultural Values on Escalation of Commitment*, 6 Int’l J. Organizational Analysis 165, 165 (1998).

44. See Staw, *supra* note 39, at 583.

45. See *id.* at 579.

46. See *id.*

47. See *id.*

48. See *id.* at 580.

49. See *id.* at 580-81.

nal investment decision than when they were not.⁵⁰ Furthermore, research suggests that context may influence a manager's decision choices. In 1995, Robert Rutledge investigated whether responsibility for a prior decision will affect decision-making in interactive groups.⁵¹ The study concluded that groups are subject to an escalating commitment when they are responsible for a prior related investment decision and indicated that groups are influenced by the framing of decision-relevant information.⁵²

Thus, once a manager (or a group of managers) begins down a course of action, he is not likely to back off from that course of action, even when there is information to suggest that it is wrong. That is to say that the top management of an organization, preparing a new product for market, is not likely to recall that product, or even slow its implementation, even when there is information to suggest that there may be problems with the product. Therefore, we have two models of behavior (groupthink and escalation of commitment) that suggest that organizations are not likely to behave in economically rational ways when making decisions.⁵³ In fact, the groupthink model suggests that these leaders are not even likely to be fully aware of the negative information that is actually available to them. The escalation of commitment model suggest that, if they do become aware of problems, they are not very likely to change their course of action.

But, of course, others within the organization, who are not as committed to a course of action, and are not members of the decision-making cadre, may also discover the potential problems. They would be more likely to try to change the course of action by bringing the problems to the attention of others, and so they would have the potential for getting needed unfavorable information to potential consumers.⁵⁴ We usually refer to such individuals as "whistleblowers," and there are some interesting points to how organizations usually deal with them.

50. Robert W. Rutledge, *Escalation of Commitment in Groups and the Moderating Effects of Information Framing*, 17 *Mgmt. Res. News* 12 (1994).

51. See Robert W. Rutledge, *Escalation of Commitment in Groups and the Effects of Information Framing*, 11 *J. Applied Bus. Res.* 17 (1995).

52. See *id.* at 20-21.

53. See Janis, *supra* note 23 and accompanying text.

54. See Janet P. Near & Marcia P. Miceli, *Effective Whistle-Blowing*, 20 *Acad. Mgmt. Rev.* 679, 680 (1995).

Whistle-blowing

A "whistle-blower" is someone who alerts someone else of a problem within the organization.⁵⁵ This communication may be internal only, as a concerned employee notifies a supervisor of some wrongdoing by another employee. In the past, the forces operating in most organizations were clearly designed to discourage whistle-blowers, and there were many documented cases of retaliation against whistle-blowers.⁵⁶ Today there are two contradictory trends regarding whistle-blowing. First, judges and legislators expanded protection for the whistle-blower in regards to corporate retaliation.⁵⁷ This trend's purpose is to motivate those within an organization to report organizational wrongdoing. However, the use of secrecy clauses has tremendously increased, preventing the public from accessing negative information. This has unfortunately caused judges to enforce secrecy agreements against the whistle-blower.⁵⁸ Significantly, the enforceability of these clauses is dependent on the motive for the disclosure, what the information will protect, the magnitude of the offense and the amount of evidence of the misconduct. The benefits for the employer are twofold: first, employers are gaining needed extra protection and, more importantly, the employer can require an employee to report wrongdoing internally first.⁵⁹

But organizational reactions to whistle-blowing are not really as simple as all that. Near and Miceli have proposed a model of whistle-blowing effectiveness.⁶⁰ From their perspective, the ultimate goal of whistle-blowing is to cause the organization to terminate the wrongful practice.⁶¹ They note that this is more likely if the person making the allegations has credibility and some power in the organization.⁶² They further argue that effectiveness is a

55. See *id.*

56. See, e.g., Janet P. Near & Marcia P. Miceli, *Retaliation Against Whistle-blowers: Predictors and Effects*, 71 J. Applied Psych. 137 (1986); Janet P. Near & Marcia P. Miceli, *Whistle-Blowers in Organizations: Dissidents or Reformers?*, in 8 Res. in Organizational Behav. 321 (Barry M. Staw & Larry L. Cummings eds., 1987).

57. See Near & Miceli, *supra* note 53, at 680.

58. See Terry Morehead Dworkin & Elletta Sangrey Callahan, *Buying Silence*, 36 Am. Bus. L.J. 151 (1998).

59. See *id.* at 190.

60. See Near & Miceli, *supra* note 53, at 688-703.

61. See *id.* at 686.

62. See *id.* at 686-88.

function of the nature of the wrongdoing, and whether or not it is clearly illegal (which should increase the chance of the wrongdoing being halted).⁶³ But, they also note that effectiveness is related to the extent to which the organization is dependent upon the wrongdoing.⁶⁴ So, for example, if an organization relies heavily upon bribes to win contracts, the organization is more likely to fight the whistle-blower, and less likely to change the practice. Near and Miceli go on to note that, under these circumstances, although internal whistle-blowing may be less effective, external whistle-blowing should be more effective, as long as the evidence of the wrongdoing is compelling.⁶⁵

The critical point is that whistle-blowing is less likely to be effective and more likely to result in retaliation, the more the organization is reliant upon the wrongdoing. Thus, whistle-blowing is less likely to change behavior and even less likely to occur (for fear of retaliation) in those cases where we, as consumers, would most like the whistle-blowing to be effective. In fact, Ettore notes that:

[I]n today's supposedly enlightened business world, corporate America continues to treat its whistleblowers poorly. The notion persists that it is disloyal and irresponsible to criticize one's employer, notwithstanding the fact that the company has done wrong Other than outright dismissal, retaliation can and does include demotion, false complaints about job performance, reassignment and relocation, [and] assignment of unsympathetic co-workers or supervisors Mistreated employees have legal avenues for redress, although many of these laws are enforced by the same systems in which the charges originated.⁶⁶

Furthermore, Near and Miceli note that whistle-blowing is more likely to be effective in organizations where the culture supports openness and trust and discourages retaliation against whistle-blowers.⁶⁷ They discuss the ethical and moral climate of organizations as being critical factors in this determination.⁶⁸

63. *See id.* at 698.

64. *See id.* at 695.

65. *See id.* at 697.

66. Barbara Ettore, *Whistleblowers: Who's the Real Bad Guy?*, 83 *Mgmt. Rev.* 18, 19-20, 22 (1994).

67. *See* Near & Miceli, *supra* note 54, at 699.

68. *See id.*

Again, if potential whistle-blowers believe that their actions will not have the effect of terminating the wrongdoing, *and* they believe there is a good chance for retaliation, they will often simply decide not to raise the issue in the first place. Although this decision, on the part of the individual employee may be quite rational from an economic perspective, the fact that the person decides not to call attention to the problem means that the organization will not have the information it needs to make a rational decision.

But, finally, the unfavorable information may get out. The consumer has the information (in a few cases) that she or he needs to make a rational decision, but the organization's interference is not yet over. It is possible for the organization to present the unfavorable information in such a way that the consumer will not react to it as expected. In fact, as we shall see, some organizations have been able to use "accounts" of wrongdoing as a way to actually increase their legitimacy in the eyes of consumers and society.

Accounts of Wrongdoing and Legitimacy

Finally, we will take our analysis one more step. In some situations, it is clear that the organization will simply not be able to suppress the information about problems and/or wrongdoings—someone will find out and leak it to others. It is interesting to note that there is a body of evidence that suggests the company's opportunities to manipulate information available to the public are still not over. Although people may know *what* happened, the company can still work to get out a favorable story about *why* it happened. Several researchers have examined these processes in action and have suggested ways in which organizations can manipulate the perceptions of their legitimacy by telling different stories about how things went wrong or why they went wrong.⁶⁹ Note that the organization that finds itself at this point in the process *is* probably acting rationally when it tries to manage the accounts that get to the public.

For example, in 1990, Waldenbooks had apparently received bomb threats because they had continued to sell "The Satanic

69. Kimberly D. Elsbach & Robert I. Sutton, *Acquiring Organizational Legitimacy Through Illegitimate Actions: A Marriage of Institutional and Impression Management Theories*, 35 Acad. Mgmt. J. 699, 718-23 (1992).

Verses.⁷⁰ Soon thereafter, they removed the book from their bookshelves, and various groups immediately criticized the company for ignoring basic notions of freedom of speech. In fact, various groups began picketing Waldenbooks' stores around the country. The situation seemed simple—Waldenbooks had apparently given in to pressure by Islamic fundamentalists and had stopped selling the book—even though these actions would not be consistent with our basic ideas about free speech. But Waldenbooks fought back, stating that they hadn't really withdrawn the book. Instead, they were waiting for further shipments to reach stores, but, in the meanwhile, they were shipping orders from their warehouses. They also noted how brave their employees were to work under the fear of bomb threats. In this way, Waldenbooks deflected criticism that they were bowing to pressure since they stated they were still selling the book, and they changed the focus to the bravery of their employees. Thus, they worked to establish their legitimacy in this crisis and to manage the impressions of the public about their behavior.⁷¹ In other cases, organizations have used “de-coupling” where the management distanced themselves from the people who actually made the decisions that caused the problems.⁷² Such a strategy might work, for example, in an academic institution where the President could “blame” a problem on the University Foundation, which is an independent body. In still other cases, organizations act quickly and decisively to deal with the problem, thus deflecting criticism about the cause of the problem in the first place (the Tylenol response), or they can simply note that any harm was unintentional, and, again, move to rectify the problem.⁷³

In any case, the company can work to limit the damages that are associated with the problem by “telling a story” that puts the company in more favorable light.⁷⁴ Thus, if all else fails (relative to controlling information), the company can still distort the way in which consumers use that information to make decisions by manipulating the consumers' attribution for blame. Perhaps the

70. See generally *id.* (providing a detailed account of the Waldenbooks controversy).

71. See *id.* at 729-30.

72. See *id.* at 715-17, 724.

73. See *id.* at 729.

74. See Kimberly D. Elsbach, *Managing Organizational Legitimacy in the California Cattle Industry: The Construction and Effectiveness of Verbal Accounts*, 39 *Admin. Sci. Q.* 57, 58-60 (1994).

most amazing use of these tactics can be found at Disney. Over the years, a number of people have been injured on rides at Disney theme parks.⁷⁵ Several of these individuals have attempted to sue Disney, but no one has done so successfully.⁷⁶ The Disney defense includes references to Mickey Mouse and good, clean family fun, as well as information about the care and maintenance they give to their rides.⁷⁷ The combination seems irresistible to jurors who have problems finding the people who brought us Mickey and Donald, guilty of negligence.⁷⁸

CONCLUSION

Human fallibility would seem to be a prodigious adversary to the law and economics model. Consumers often make irrational decisions because of the operation of various cognitive biases. But, even if these biases were not in operation, consumers would have a difficult time making rational decisions because the organizations involved limit the (unfavorable) information available to the consumer, either consciously or unconsciously. How do consumers effectively evaluate "risk" when they lack the needed information? We would argue that they could not in most cases. Consumers rarely, if ever, have all the information to evaluate the true benefits, so that they may compare that to the price of the product? To make the consumer accountable for faulty products, as the law and economics theory states, would logically require that the organization acted "rationally" and allowed all relevant information to get to the public.

But we have discussed a number of reasons why this is not the case. Internal decision-making processes (such as groupthink) may insure that the management of the company itself does not know about potential problems. When managers learn about any such problems, they are more likely to ignore them, and continue on the same course of action to which they were already committed. If any employee does call a problem to the attention of the management, and the message is received, the employee might decide to become a whistle-blower, despite the heavy price he or she

75. See generally David Koenig, *Mouse Tales: A Behind-The-Ears Look at Disneyland* (1994) (recounting Disney's management of negligence claims against it).

76. See *id.*

77. See *id.*

78. See *id.*

may have to pay for that decision. Finally, even when unfavorable information does manage to get to consumers, companies work to "spin" the story in such a way that they can escape much of the blame. Therefore, we cannot rely on rational decisions and efficient markets to guard the rights of consumers. We need instead a strong system of tort laws that allow individuals to sue negligent organizations and to be compensated for damages. Consumers also deserve to receive payment for punitive damages in cases where organizations are aware of problems and actively seek to keep this information from consumers.

In closing, we have two more brief observations. One is that research has actually identified some characteristics of organizations that are actually involved in *illegal* actions. Although we believe this information is interesting, we must point out that the studies involved are based only on organizations that have been *caught* breaking the law. Therefore, the information we are about to present may actually tell us more about unsuccessful criminal actions, than about criminal actions in general.

In any case, according to a study by Baucus and Near,⁷⁹ illegal actions are most likely to be committed by companies that are:

- large (such acts are presumably easier to hide inside such companies)⁸⁰
- operating in dynamic environments (lots of changes and challenges may make such actions more attractive as a means of gaining advantage)⁸¹
- operating in munificent environments (high growth rates usually result in people willing to take greater risks so as to make greater gains)⁸²
- operating companies in the food, lumber, petroleum refining and automobile industries⁸³

In this study, illegal acts mean violations of the law in the following areas: product liability, anti-trust, environmental and discrimination. Interestingly, the automobile industry was the clear

79. See Melissa S. Baucus & Janet P. Near, *Can Illegal Corporate Behavior Be Predicted? An Event History Analysis*, 34 Acad. Mgmt. J. 9 (1991).

80. See *id.* at 14-15.

81. See *id.* at 13.

82. See *id.* at 12.

83. See *id.* at 17.

winner in terms of the most product liability cases, from 1974 to 1983.⁸⁴

In addition, a study by Daboub, Rasheed, Priem and Gray suggested that these relationships could be moderated by the top management team (TMT) makeup.⁸⁵ Specifically, they argue that the relationship between these factors and illegal activities will be weaker when:

- the TMT is older and has more tenure in its role⁸⁶
- TMT members are better educated⁸⁷
- the TMT is less homogeneous (i.e., more diversity in terms of race, age, gender and background—presumably this would reduce the effects of groupthink)⁸⁸

Finally, when we first read about the ideas of the law and economics movement, we were a bit surprised that anyone would actually suggest that companies sell products for a lower price, knowing that they are risky, and that consumers would be accepting that risk by paying the lower price. We really didn't think about these issues in those terms. But, learning something new makes you more aware of other instances with similar circumstances. Therefore, we will end with a recent article found in a popular travel magazine.⁸⁹

The article described the Smart, a tiny car (a two-seater, that is only 8.2 feet long) manufactured by a division of DaimlerChrysler, conceived of by the founder of Swatch, and sold exclusively in Europe.⁹⁰ DaimlerChrysler projected sales of 130,000 units in its first year, but those projections fell sharply (to 30,000) as tests indicated that the "Swatchmobile" (as it is unofficially known) had a tendency to tip over during lane changes.⁹¹ In addition, drivers began to complain about losing control on icy roads.⁹² Rumors suggested that, after these problems, DaimlerChrysler

84. *See id.*

85. *See* Anthony Daboub et al., *Top Management Team Characteristics and Corporate Illegal Activity*, 20 *Acad. Mgmt. Rev.* 138, 139 (1995).

86. *See id.* at 152-53.

87. *See id.* at 155.

88. *See id.* at 157-58.

89. *See* Erik Torkells, *Get SMART: The Smart Car in Paris*, *Travel and Leisure*, Nov. 1999, at 156-57.

90. *See id.*

91. *See id.*

92. *See id.*

would stop making and selling the car, but it turned out that these rumors were false.⁹³ Rather than discontinuing the potentially dangerous car, the company will continue selling Smarts (hopefully improved), but, apparently in recognition of the inherent risk to the consumer, they will simply sell the cars for a lower price!⁹⁴

93. *See id.*

94. *See id.*

