

## **A Corporate Hero with Scandal: Lessons Learned from Martha Stewart's Insider Trading Crisis**

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### **Abstract**

*Martha Stewart places her name on her products. She becomes the face of her company and the voice of her brand. When her personal misconduct occurred, she made her company vulnerable and risky as well. This case-study examines how Martha Stewart managed her corporate communication when her public image and reputation were tarnished on trial for alleged insider trading scandal. The trial not only led her to prison but also hurt her brand equity. The study shows that Stewart's early response to her crisis demonstrated lack of situation awareness. In the beginning of her investigation, she kept her public persona intact, ignoring or downplaying her role in it. As a result, what Stewart called "a small personal matter" later became a full-blown crisis. If she had managed her communication in a more timely manner, the magnitude of her crisis might have been minimized. This article also provides detailed insights for organizations to learn from her crisis response strategies.*

**Keywords:** Organizational crisis, Crisis communication, Image restoration

### **1. Introduction**

The personalities of strong business leaders can help shape and enhance their corporate image. In some cases, the leaders become the virtual icon of the corporate brand, lending their personal prestige to the brand and personifying the company. They can also threaten the company when they are involved in a scandal. In this situation, the consequences for the company can be critical as in the Martha Stewart's insider trading crisis in the United States. The crisis management scholar, Roux-Dufort (2000) points out that corporate crises as "a privileged moment during which to understand things differently" (p. 26). As such, there is a growing body of literature on organizational learning in the wake of corporate crisis (Mitroff, 2002; Shrivastava, 1998). The Stewart case, in particular, drew the attention of media for years. The crisis of Martha Stewart's insider trading raised the issue about the Martha Stewart's multiplatform franchise; that is, the media world and homemaking business are intricately interwoven with her persona. Stewart's empire has an impressive business synergy as shown by her TV programs that promote her magazines, her website which sells her products, and her products which are a link to her TV programs.

She is the face, voice and personality behind the brand and, thus, the two – Stewart and the brand – are inseparable. After Stewart's personal misconduct, the interlocking nature of her business proved to be vulnerable and risky. Moreover, Stewart's crisis had both legal and public relations components (Jerome, Moffitt, & Knudsen, 2007). Allegations of insider trading against Martha Stewart led to her imprisonment. Her strategic plan in response to the insider trading accusations and the media attention surrounding this crisis left Stewart trying to take action to restore her image. In a sense, it is important to understand how Stewart herself and her company managed their corporate communication when her public image and reputation were tarnished under the investigation of the insider trading scandal. This article explores how the high profile iconic Martha Stewart responded when confronted with an organizational crisis that threatened existence. It also provides detailed insights for organizations to learn from her crisis response strategies.

### **2. Background of Martha Stewart's Insider Trading**

Beginning with the 1982 publication of her book *Entertaining*, Martha Stewart made a name for herself as a homemaking diva. In September 1997, Stewart became chairperson, president, and CEO of her new company, Martha Stewart Living Omnimedia. Martha Stewart Living Omnimedia has been listed on the New York Stock Exchange under the ticker symbol MSO since 1999. As the chief of MSO, Stewart used her name and face to make connections with various businesses including a line of housewares, television shows, radio channels, magazines and a series of books on entertaining.

On December 27, 2001, Stewart sold 3,928 shares of her ImClone stock worth US\$228,000 the day before the U.S. Food and Drug Administration (FDA) rejected approval of Erbitux, ImClone's anti-cancer drug. By selling ahead of the FDA rejection, Stewart received about US\$45,000 more than if she had sold the stocks later. Compared to her wealth, it was certainly an insignificant sum and in fact, during her *Larry King Live* interview, she said it was "miniscule, really, about 0.006 percent of my net worth" (Fournier, 2004). Stewart had denied any wrongdoing, insisting she did not receive any advance knowledge from Sam Waksal, the founder and CEO of ImClone about the decision on Erbitux (Pollack, 2002). Instead, her sale of ImClone stock was part of a predetermined plan to sell if shares fell below US\$60. Later, Stewart was officially indicted on charges of securities fraud and obstructing justice related to her sale of ImClone stock on March 5, 2004. Judge Cedarbaum dismissed the securities fraud charge against Stewart, saying prosecutors had failed to present enough evidence on the issue (Masters & White, 2004). However, obstruction of justice, charges of conspiracy, and making false statements remained. Stewart served a five-month prison sentence between October 8, 2004 and March 4, 2005 for these charges. On August 7, 2006, Martha Stewart reached an agreement with the securities' regulators over the insider-trading civil charges and agreed to pay US\$195,000 to settle a five-year legal battle.

### **3. Literature Review**

Crisis events can and do strike organizations of all types. Every kind of organization, from larger organizations to small family owned businesses, have the potential of being a victim of crisis (Seeger, Sellnow, & Ulmer, 2003). In many circumstances, crisis immediately raises questions from an organization's many different publics (Marra, 1998). In this view, for an organization to manage the effects of a crisis it must communicate to both internal and external stakeholders. Ulmer, Sellnow, and Seeger (2007) suggest all crises involve the general communication strategies of reducing uncertainty, responding to the crisis, resolving it, and learning from it. The ability to communicate quickly and effectively is clearly an important component of successful crisis management. Effective crisis communication can not only defuse or eliminate crisis, but it can sometimes bring an organization a more positive reputation than before the crisis occurred (Kauffman, 2005). On the other hand, Marra (1998) argues if an organization fails to respond to a crisis in the correct manner, a bad situation can be made worse. Hence, crisis communication strategies can substantially diminish the harm caused by a crisis or magnify the harm if mismanaged.

In this study, the stream of crisis response models from communication scholars and public relations professionals (Benoit, 1995; Coombs, 1999, 2007) are utilized as the theoretical framework to interpret the crisis response strategies that Martha Stewart employed in her insider trading crisis. According to Benoit (1995), firms or individuals may take preventative and restorative approaches to image problems. Five strategies (i.e., denial, evasion of responsibility, reduction of the offensiveness of the act, corrective action, and mortification) make up the rhetoric or image repair discourse. Each of these strategies has a set of tactics within them. Denial is the strategy employed when the rhetor simply chooses to deny the actions he is being accused of or shift the blame from the organization to outside individuals or agencies.

The second strategy is evasion of responsibility is the strategy that the rhetor can blame circumstances beyond his control. It consists of four possible tactics: provocation, defeasibility, accident and good intentions. Benoit's third major image restoration strategy, occurs when the rhetor attempts to reduce the degree of offensiveness experienced by the accuser. To this end, Benoit includes six tactics: bolstering, minimization, differentiation, transcendence, attacking the accuser, and compensation. The fourth category of the typology is corrective action, which attempts to correct the situation rather than counterbalance it. The final image restoration strategy, mortification, requires the rhetor to take responsibility for the action and to issue an apology. Benoit and colleagues have applied the model to a variety of different crisis situations. For instance, Benoit and Brinson (1994) analyzed AT&T's defense following an interruption of its long-distance service in New York in September of 1991. Initially, AT&T tried to shift blame to low-level workers.

As the complete story emerged, however, AT&T apologized for the interruption (mortification) and began to bolster its image by stressing its commitment to excellence, the billions of dollars invested in service, and the quality of its employees. Finally, AT&T promised corrective action and introduced a comprehensive review of its operations to anticipate and prevent further problems. It also stressed its commitment to providing excellent service and its willingness to spend billions of dollars to do so. Given these corrective action strategies, AT&T's finally restored its image. Benoit (1995) also examined Union Carbide's response to the Bhopal, India, gas leak that killed thousands and injured hundreds of thousands.

Union Carbide's primary strategies, bolstering and corrective action, were focused on four specific actions: a relief fund, an orphanage, medical supplies, and medical personnel. Although these strategies were appropriate and timely, Benoit claimed that Union Carbide failed to address the most important question: What were they doing to prevent another tragedy?

Coombs (1999, 2007) develops situational crisis communication theory, creating 10 categories of basic organizational crisis communication strategies. These strategies are further grouped into four posture: 1) "denial posture" including attack the accuser (confronting person claiming a crisis occurred), denial (asserting no crisis), and scapegoat (shifting the blame to others outside the organization), with an attempt to eliminate the crisis by denying its existence or the organization's responsibility for the crisis; 2) "diminishment posture" which takes the forms of excuse (denying intend to do harm or claiming inability to control) and justification (minimizing severity of damage) with the purpose of weakening the link between the crisis and the organization by claiming the crisis is not the organization's fault; 3) "rebuilding posture" of compensation (providing money or other gifts to the victims) and apology (taking full responsibility), which strives to restore legitimacy by seeking public approval and forgiveness; and 4) "bolstering posture" which includes reminder (telling stakeholders about its past good works), ingratiation (praising stakeholders and/or reminds them of past good works) and victimage (reminding stakeholders that the organization is a victim of the crisis, too).

Using Coombs's typology of crisis response strategies, Wilcox and Cameron (2006) examined the case of Intel. In 1993, Intel initially denied there was a problem with its Pentium 586 chip. As the crisis was covered in the mainstream press, Intel used the justification strategy by assuring that the problem was not serious enough to warrant replacing the chips. It minimized the concerns of consumers. In fact, Intel mismanaged the handling of its crisis communication. First, it did not disclose to the public the information about the Pentium flaw when they initially realized there was a problem. Then when the problem finally did come out into the open, they downplayed it instead of helping the users who had purchased the flawed chips. After considerable damage had been done to Intel's reputation and IBM had suspended orders for the chip, Intel took corrective action to replace the chips. Subsequently, Andy Grove, Intel's president, issued a full apology.

Based on Benoit's image repair theory and Coombs's typology of crisis response strategies, the following research questions are posited:

RQ 1. What strategies did Martha Stewart use to manage her insider trading crisis?

RQ 2. Were these strategies effective or ineffective?

RQ 3. What can we learn from Martha Stewart case?

#### **4. Methodology**

The case study is employed in this study, as it is effective in illustrating public relations management in real situations (Hendrix, 2004). According to Yin (1994), the six sources of evidence that are typically associated with the case study include documents, archival records, interviews, direct observation, participant-observation, and physical artifacts. In this study, texts documenting Stewart's discourse in response to incidents that threatened her image were collected from multiple sources. Specifically, this study used predominantly two types of data: documents and archival records. It began with gathering data and finding facts related to cases and defining the specific tasks. The actions and communication strategies used by Martha Stewart were reviewed with information from her corporate websites, press releases and media coverage. MSO is a publicly traded company. A look at the organizational archival records (e.g., stock prices, sales and annual reports) and official government records (e.g., court records and commission reports) contributed to understand the impact of corporate scandals have had on the companies' financial performance and their stakeholders.

The media coverage on the Martha Stewart case was found through Lexis Nexis Academic keyword search of "Martha Stewart & insider trading" in *The New York Times* and *The Washington Post*. These newspapers were selected because of their large circulation, prominence and influence on public opinion. For the purpose of the valance of news narration in this study, the period of analysis covered two time frames (during the crisis and post-crisis). The first time frame started from the trading day to the verdict, beginning in December, 2001 and running through March, 2004. The second time frame started from the day of sentencing to her release from prison, beginning on July 16, 2004 and running through March 2005. Since the research questions of this study were related to crisis communication strategies, the unit of analysis of this case study was Martha Stewart's response to stakeholders during and post crisis. Thus, the strategies were apparent through the types of evidence.

By examining corporate communication employed by Martha Stewart during the crisis and post-crisis period, the procedures for analysis involved three steps.

First, after the data were collected from multiple sources, a detailed timeline of relevant events leading up to the crisis itself, and the post-crisis process was created. For example, the chronological order of the Martha Stewart case was constructed in the following manner: 1) the investigation (January, 2002 - June, 2003); 2) indictment (June – December, 2003); 3) verdict (January - May, 2004); 4) sentencing (June – July, 2004); 5) in prison (October, 2004); and 6) release from prison (March, 2005). Second, after the chronological order of actual events was refined, a narrative description and process analysis of each event was thus constructed. A worksheet served as an organizing tool for evaluating each event. All data collected were analyzed using the typology of crisis response strategy. Finally, a thick description and analysis of the findings of each research question was conducted.

## **5. Analysis of Martha Stewart's Crisis Response Strategies**

### **5.1 Investigation**

The story about Martha Stewart's ImClone stock sale was broken to the public in the *Wall Street Journal* on June 7, 2002 (Adams & Anand, 2002). In the article, her lawyer, John Savarese, indicated that Stewart had set the price at US\$60 for selling the stock but in fact, as of June 7, 2002, the stock price of ImClone sank to a low US\$8.45 a share. Using the strategy of differentiation, Savarese further was trying to put distance between Stewart and Sam Waksal.

There is absolutely no evidence whatsoever that she spoke to Sam, or had any information from anybody from ImClone during that week ... I am absolutely sure that there was no communication of any kind between her and Sam, no passing of any information from him to her. (Adams & Anand, 2002, p. B2)

On June 12, 2002, Waksal was arrested for insider trading and soon after, the stock price of MSO plunged 12 percent, closing at US\$15. From June 6, 2002, when congressional investigators started looking into Stewart's sale of ImClone shares, the stock price of MSO had dropped 22 percent. Stewart immediately denied any insider trading or wrongdoing and, in a public statement, she said she knew nothing about the pending FDA announcement. She claimed that when the share price dropped below US\$60 – the level at which she had agreed with her broker – she returned a call from her broker and sold the shares on December 27, 2001. She acknowledged that after the trade, she immediately called Waksal but could not reach him, and he did not call her back. The message she left read: "Martha Stewart called. Something is going on with ImClone and she wants to know what" (Hays, 2002a, p. C1). She proclaimed her innocence in her statement: "In placing my trade, I had no improper information. My transaction was entirely lawful" (White, 2002, p. E1). However, the congressional investigator questioned Stewart's sale, noting that ImClone dropped below \$60 at least once before while Stewart owned it (White, 2002).

On June 18, 2002, Stewart tried to resolve concerns about her sale of ImClone shares and hired a new lawyer, James F. Fitzpatrick, who submitted several documents to congressional investigators. This was the first time Stewart used a strategy of corrective action as a response to the inquiries. On June 19, 2002, MSO stock rebounded sharply, climbing from US\$2.05, to US\$14.4 and then to US\$16.45, suggesting that her corrective action was working. However, Ken Johnson, a spokesman for the House Energy and Commerce Committee, said the documents would help answer some questions but "we still don't have an answer to the most nagging one: was Ms. Stewart's pre-existing agreement to sell reached in late November, as she says, or in mid-December as some reports have indicated?" (Hays, 2002b, p. C7). On June 25, 2002, she appeared on CBS's *The Early Show*, and when asked by the host, Jane Clayson, about the ImClone shares during a cooking segment, she replied while slicing a cabbage with a big knife.

I'm involved in an investigation that has very serious implications. I have nothing to say on the matter. I'm really not at liberty to say. And as I said, I think this will be resolved in the very near future and I will be exonerated of any ridiculousness. And I just want to focus on my salad because that is why we're here. (Clayson, 2002)

Apparently, Stewart had no idea how to handle the situation and was unwilling to respond to the questions. She continued to dodge public inquiries and ignored the increasing outcry for answers about her role in the insider trading scandal.

When CBS News continued to ask her questions about the ImClone shares investigation, Stewart suspended her association with the program and constantly denied allegations of wrongdoing and maintained her innocence. Shares of Martha Stewart's company stock continued to plunge and fell from US\$3.2 to US\$10.4. This was a record low as new questions emerged about her sale of the ImClone stock. Subsequently, Stewart hired another criminal lawyer, Robert G. Morvillo, as well as a crisis-management public relations firm, the Brunswick Group, to manage her increasingly complicated affairs (Hays & Pollack, 2002). As for internal communication with her employees, there were no meetings or any other communication between company management and the rest of the staff, except for two-email messages. The employees had to read the newspapers and watch television just like the public to find out what was happening with MSO (Hays & Pollack, 2002).

On July 24, 2002, MSO acknowledged for the first time that Stewart's legal problems had an impact on the company's business operation. Advertising sales for the flagship magazine were flat and retailers were not purchasing products, such as floor coverings and furniture, at the rate the company originally expected. There were also other unanticipated costs, such as the hiring of additional lawyers and public relations specialists. In response to this financial situation, Stewart held a conference call with analysts and investors. Using a strategy of differentiation, she claimed that she and her company should be considered separately, although virtually every product, publication and broadcast program produced by the company bore her name (Hays, 2002c). At this point in time, she made an attempt to disassociate herself from the company. She added: "It has been extremely difficult and painful for me to see a private matter of mine create a challenging environment for our company and its employees" (Hays, 2002c, p. C1). Investors were clearly affected by the investigation. Analysts at Merrill Lynch also wrote in a note to investors that "as we are unable to forecast the duration and magnitude of the impact on the business, we are placing the stock under review" (Hays, 2002c, p. C1).

Due to the negative publicity and following the suggestions of her public relations advisers, Stewart agreed to a formal interview about the investigation and the public's reaction in the February 3, 2003 issue of *The New Yorker* magazine. Breaking a seven-month silence, Stewart discussed the damage to her business and described the public reaction as "puzzling and also confusing" (Toobin, 2003). She did not speak about the sale of the 4,000 ImClone shares. Stewart estimated that the investigation had cost her at least four hundred million dollars, mostly in the decline in value of her MSO shares, legal fees and lost business opportunities. Although she was under investigation, she vowed never to walk away from her company.

## **5. 2 Indictment**

On June 4, 2003, Martha Stewart was indicted on criminal charges. Stewart's charge included conspiracy, obstruction of justice and securities fraud - all linked to ImClone shares trading in 2001. The Securities and Exchange Commission (SEC) also sued her for insider trading. According to the indictment, Stewart fabricated and attempted to deceive investigators with a fictitious explanation, telling them that she and her stockbroker had previously agreed to sell the shares if their market value fell below \$60. The indictment also claimed that she had altered a phone message from the broker in her assistant's computer immediately following a lengthy conversation with her attorney (Hays, 2003a).

By responding to the indictment, Stewart's lawyers issued a statement saying "she was being made the subject of a criminal test case designed to further expand the already unrecognizable boundaries of the federal securities laws and they predicted that she would be fully exonerated" (Hays, 2003a, p. A1). Stewart's criminal lawyer, Robert Morvillo, used the strategy of attacking the accuser and further suggested that his client had become a target for government prosecutors on account of her fame. He asked in a statement and challenged the motives behind her charges: "Is it for publicity purposes, because Martha Stewart is a celebrity" (Eichenwald, 2003, p. C4). At a news conference announcing the charges against Stewart, James Comey, the United States attorney for the Southern District of New York, insisted that "this criminal case is about lying, lying to FBI, lying to SEC, lying to investors" and he added "Martha Stewart is being prosecuted not for who she is, but because of what she did" (Hays, 2003a, p. A1).

On June 5, 2003, the day after her indictment, Stewart took corrective action by stepping down as chairperson and CEO of MSO (Hays, 2003a). Sharon Patrick was appointed as the new chief executive officer and Jeffrey Ubben, a major shareholder was succeeded as chairperson. Nevertheless, Stewart did not completely separate herself from MSO. She remained on the board of directors and remained a force as the company's chief creative officer. Meanwhile, Stewart started a campaign to restore her public image.

She paid for a full-page advertisement in the *USA Today*. In the advertisement, she denied receiving insider information and maintained her innocence. She tried to salvage her reputation through her public relations specialists and legal advice team. She was interviewed by both Larry King and Barbara Walters, two carefully planned television appearances that allowed her to proclaim her innocence to large audience (Hays & Eaton, 2004). She also launched a website *www.marthataalks.com* with an open letter of defense “to my friends and loyal supporters.” The spokesman of MSO said the website was to stay in direct touch with Stewart in public (Hays, 2003b). It was thought that the direct communication helped her image and would encourage public support. Within the first 16 hours, *www.marthataalks.com* received more than one million hits and about 12,000 emails messages (Hays, 2003b). On the website, she argued that the government brought charges against her for matters that were personal and entirely unrelated to the business of MSO. By using denial and attacking the accuser strategies, Stewart further asserted that,

I want you to know that I am innocent – and that I will fight to clear my name ... The government’s attempt to criminalize these actions makes no sense to me ... I am confident I will be exonerated of these baseless charges, but a trial unfortunately won’t take place for month. (Hays, 2003b, p. 1)

### **5.3 Verdict**

On March 5, 2004, a jury of eight women and four men reached a verdict and found Stewart guilty on all counts of conspiracy, obstruction of justice and making false statements. In fact, earlier, Judge Cedarbaum had already tossed out the most serious charge, securities fraud, against Stewart (Masters & White, 2004). Judge Cedarbaum stated that the evidence and inferences the government was presenting was simply too weak to support a finding of criminal intent beyond a reasonable doubt. Stewart declined to comment upon leaving the courthouse. Instead, Stewart utilized a minimization strategy to diminish her charge in a statement posted on her website.

I am obviously distressed by the jury’s verdict but I continue to take comfort in knowing that I have the confidence and enduring support of my family and friends. I will appeal the verdict and continue to fight to clear my name. I believe in the fairness of the judicial system and remain confident that I will ultimately prevail. (Masters & White, 2004, p. A1)

On March 15, 2004, as a result of her conviction and in an attempt to salvage the company which bore her name, Stewart utilized corrective action and resigned her position as board member and chief creative officer of MSO. The company announced that Stewart would continue as a creative adviser, calling the move “in the very best interests of MSO and its shareholders” (Hays, 2004a, p. C1). Stewart released a statement saying she was changing her role in the company “because I think it’s the right thing to do” (Hays, 2004a, p. C1). Stewart described herself as “heartsick about my personal legal situation” and added that she was “deeply sorry for the pain and difficulties it has caused our employees” (Hays, 2004a, p. C1). To show support for Stewart, the company’s chief executive, Sharon Patrick, said the company was “deeply saddened” by its founder’s situation but added: “Wherever and whenever possible, we believe that MSO and our consumers should not be deprived of Martha’s unique gifts” (Hays, 2004a, p. C1).

### **5. 4 Sentencing & Releasing**

On July 16, 2004, Stewart received the minimum sentence – five months in federal prison, five months of home confinement, two years probation, and a US\$30,000 fine. In the courthouse, Stewart shifted the blame away from company and referred to her circumstances as a “personal matter.”

Today is a shameful day. It is shameful for me, for my family, and for my beloved company and all of its employees and partners. What was a small personal matter became over the last two and half years an almost fatal circus event of unprecedented proportions spreading like oil over a vast landscape ... I have been choked and almost suffocated to death. (Masters, 2004, p. A1)

Meanwhile, Stewart used a strategy of bolstering and asked the judge to “remember all the good that I have done, all the contributions I have made . . . My hopes that my life will not be completely destroyed lie entirely in your competent and experienced and merciful hands” (Masters, 2004, p. A1). In the remarks after the sentencing, Stewart took a more remorseful tone and apologized, asking for forgiveness from the people who lost their jobs at her company as a result of this situation. Stewart said, “I want them to know how very sorry I am for them and their families” (Masters, 2004, p. A1). She added she was,

all the while more concerned about the well-being of others than for myself, more hurt for them and for their losses than for my own, more worried for their futures than the future of Martha Stewart the person. (Hays, 2004b, p. A1)

Stewart then thanked the 170,000 people who wrote on her personal defense website. Undoubtedly, Stewart understood how to take advantage of publicity because she immediately put in a promotion for her MSO.

Perhaps all of you out there can continue to show your support by subscribing to our magazines, by buying our products, by encouraging our advertisers to come back in full force to our magazines. Our magazines are great. They deserve your support, and whatever happened to me personally shouldn't have any effect whatsoever on the great company Martha Stewart Living Omnimedia. (Hays, 2004b, p. A1)

After serving five months in jail, Stewart was released from prison on March 4, 2005, and again made headline news. She walked out of jail from Alderson Federal Prison Camp in West Virginia – wearing a handmade gray-and-white crocheted poncho by a fellow inmate. Subsequently, she wrote a statement on her website.

The last five months in Alderson, West Virginia has been life altering and life affirming. Someday, I hope to have the chance to talk more about all that has happened, the extraordinary people I have met here and all that I have learned. (Glater, 2005, p. 4)

On August 8, 2006, Stewart agreed to pay US\$195,000 to settle civil insider-trading claims, marking the end of a long and costly legal battle. The settlement also barred her from serving as a board director of a public company for five years or to engage in financial activities such as reporting about the company's profit outlook. She neither admitted nor denied wrongdoing. As for this settlement, Stewart issued a statement through her publicist: "This brings closure to a personal matter and my personal nightmare has come to an end" (Thomas, 2006, p. C1).

In short, Stewart did not manage her communication in a timely manner. As a result, what Stewart called "a small personal matter" later became a full-blown crisis. This crisis not only led her to prison but it also hurt her brand equity. Table 1 shows the crisis response strategies Martha Stewart used during the investigation, indictment, verdict, and sentencing in prison.

## **6. What Can Be Learned?**

Organizational learning is how an organization learns from and adapts to a variety of circumstances, including crises and failure. Sitkin (1996) has expounded on the notion of failure, indicating that "it is an essential prerequisite for learning because it stimulates basic organizational experimentation" (p. 542.). Jaques (2009) agrees, claiming that past crises "can be re-interpreted to provide lessons for modern organizations and often to reinforce the notion of failure to learn from history." By communicating the lessons learned, corporate leaders are taking preventive action, increasing organizational vigilance, and demonstrating the organization's value (Ulmer, Sellnow, & Seeger, 2007). Certainly, high-profile corporate crises provide a valuable resource for managerial and organizational learning and the iconic Martha Stewart insider trading case is an excellent example.

### **6.1 The Downfall of Corporate Hero**

After her indictment on June 4, 2003, the most serious impact for Stewart was damage to her company's financial performance and corporate image. Her case is unique because she is not only the founder and chief executive of MSO, but she is also the icon of her brand. The Martha Stewart Company itself, before it began trading on the New York Stock Exchange in 1999, pointed out the risk factors associated with this highly intricate relationship. The prospectus submitted to the Securities and Exchange Commission noted,

We are highly dependent upon our founder, Chairman and Chief Executive Officer, Martha Stewart. Martha Stewart's talents, efforts, personality and leadership have been, and continue to be, critical to our success. Our success depends on our brands and their value. Our business would be adversely affected if Martha Stewart's public image or reputation were to be tarnished ... Our continued success and the value of our brand name therefore depends, to a large degree, on the reputation of Martha Stewart. (Martha Stewart Living Omnimedia, 1999)

Not surprisingly, there was an immediate negative impact for the company as a result of the conviction on March 5, 2004. The stock plunged to 22.6 percent, losing \$.3.17 and closing the day at \$10.86. Figure 1 shows the change of MSO stock price during the insider trading scandal.

Two columns, distributed by The *New York Times* Syndicate, were renamed: “*AskMartha*” became “*Living*,” while “*AskMartha Weddings*” was simply “*Weddings*” (Hays, 2004c). On March 8, 2004, the syndicated TV show *Martha Stewart Living* was taken off the air on 12 local CBS stations owned by Viacom Inc. and a few UPN local stations, including those in major media markets such as New York, Chicago and Los Angeles (Hays, 2004c). It was estimated that they lost nearly half of their viewers from the time of the verdict. Fombrun (1996) suggests that restoration of a company’s reputation after a crisis requires the removal of all negligent incumbent managers and the appointment of credible leaders. From the time the scandal broke, MSO began distancing itself from her image by not using her name on some of their products. She also stepped down from the position of chief executive and chairperson of the board.

The conviction proved detrimental to a brand so intimately associated with a single personality. Galford and Drapeau (2002) point out that if the leadership is unethical, employees and customers lose trust in the capacity of the organization to meet their needs. Furthermore, if clients do not trust an organization, they generally take their business elsewhere. When employees’ trust and confidence in the leadership is compromised, productivity and loyalty suffer as a result. On the courthouse steps after her conviction, Stewart told the press, “Whatever happened to me personally shouldn’t have any effects whatsoever on the great company Martha Stewart Living Omnimedia” (Hays, 2004b, p. A1). Unfortunately, that was not the case. Stewart did not seem to realize that her business empire was based on her persona. Without her iconic figure, there was no MSO with which stakeholders could identify.

## **6.2 Stakeholder Perception**

Martha Stewart went from a celebrity entrepreneur to a defendant caught up in her own lying to federal investigators. After Stewart was indicted, a poll released by the Siena Research Institute at Siena College in New York on June 13, 2003, found that 60 percent of the 567 people interviewed thought Stewart was guilty of insider trading and 51 percent thought she was guilty of obstruction of justice (Hays, 2003c). Fifty four percent thought she should be punished if convicted. Also, 22 percent said her legal problems would make them think twice about buying her products. Later, in a similar poll conducted by *The Washington Post* and released on January 20, 2004, found that 58 percent of the 1,036 adults said they believed that the charge that Stewart obstructed justice was “probably true,” while 23 percent believe it was “probably false” (White & Masters, 2004). Such data suggest that negative media messages shaped the audience’s opinions more than any message put out by Stewart (Jerome, Moffitt and Knudsen, 2007). In a sense, Stewart’s lack of response to the crisis significantly impaired her image.

In addition to jokes on the websites, blogs, and late night talk shows, she has been exposed in two unauthorized biographies and a NBC TV movie in which Cybill Shepherd portrayed her as a shrewd and manipulative woman. Stanley and Hays (2002) claimed that her peers in the media world said she had not stored up enough goodwill for them to stand by her through this crisis. The audiences of *The Martha Stewart Living* television program decreased 50% after her trial due to sponsors and networks withdrawing their support (Martha Stewart Living Omnimedia Annual Report, 2004). The net loss in profit in 2003 was \$2.7million as compared to 2002 when there was a profit of \$7.2 million. Figure 2 shows the revenue of MSO between 2001 and 2005. Clearly, the trial and conviction of Martha Stewart had a resounding and negative fiscal impact on her company and shareholders certainly suffered.

## **6.3 Transparency and Open Communication**

When a crisis strikes, communication is critical for protecting the organization’s image and reputation. An effective response might even prevent the crisis from escalating. Specifically, what an organization says and how it is said are key elements in managing and reducing uncertainties and confusion during the crisis and the post-crisis period. In one media inquiry into the trading scandal, Stewart avoided answering by saying “I want to focus on my salad,” which provided late night talk show hosts with fertile joke scripts. Stewart continued to profess her innocence and to deny receiving any improper insider information on ImClone shares from Waksal. She justified this statement by claiming that she had had a pre-arranged stop-loss order with her stockbroker, Bacanovic, to sell her ImClone shares if the price went below US\$60 per share. However, since there was no supporting evidence for her claim and she really did not explain her position publicly, she was unable to shake the public debate about her timing of the sale. Through the trial phase, Stewart kept her public persona intact by ignoring or downplaying her role in the scandal. Stewart’s legal team attempted to keep her legal issues separate from her business empire. Accordingly, Stewart disassociated herself from her company by saying it was a “personal matter.”



In addition, her attorneys strongly positioned her as the innocent victim whose conduct in the stock sale was blameless. When Barbara Walters asked her in a television interview, “As you sit here today, can you tell me if you are guilty or innocent?” Stewart replied with denial, “I would like to say, out loud that I have done nothing wrong, Barbara. I am innocent. And I think that the judicial system, the upcoming trial, will prove that” (Walters & Stossel, 2003). Her statements continually shifted the blame, telling her audience that she was innocent of any wrongdoing, and implying that the government had wrongly accused her (Jerome, Moffitt, & Knudsen, 2007). Obviously, Stewart intended to portray herself as a scapegoat of the post-Enron witch hunt against corporate excess and corporate scandals.

Stewart’s mistake was to forget that her actions reflected directly on her brand and company. Most importantly, her “no comment” approach left the media free to speculate that there was something she was hiding. Many lawyers advise defendants to say little or nothing due to legal consequences or liability. Specifically, they typically argue that any statement about the crisis could be used against the organization and could increase the liability the organization would have to face (Ulmer, Sellnow, & Seeger, 2007). In fact, Stewart’s lawyer, Morvillo, did not approve of the interview with *The New Yorker* when Stewart finally broke a seven-month silence to talk about how much money she had lost and how people seemed to dislike her (Hays & Eaton, 2004). In essence, Stewart did not respond effectively partly because her lawyers attempted to limit the flow of information. Benoit (1997) argues, however, that image repair may conflict with avoiding lawsuits, and the company must decide whether it is more important to avoid litigation or restore its image.

Another major problem was that Stewart underestimated the importance of effective employee communication during this crisis. Left in a vacuum, employees often seek their information by filling in the blanks with rumor or speculation. Stewart could have communicated with her internal stakeholders and guided them to speak up for the company. Ideally, companies in times of crisis would have direct communication channels with key constituencies, such as internal employees and external stakeholders to avoid reliance on the media for speculating or carrying out the companies’ key message. Ulmer, Sellnow and Seeger (2007) reveal that failure to be open and honest usually compounds the crisis and makes the media even more aggressive. Noticeably, Stewart avoided the media in the beginning of the investigation. Her attitude seemed to be: “I am Martha Stewart. It should be good enough that I say I am innocent” (Slater, 2006, p. 101). The problem was that because of her lack of response, reporters began to question her innocence. While claiming her innocence, she offered nothing that would help clear her name. Given the above, this trial sent an important message about enforcing the transparency of financial markets. It also made executives think twice before lying to stakeholders and government officials.

#### **6.4 Image Restoration**

During her five-month jail term, Stewart began restoring her image by making friends with inmates and teaching yoga in prison. She used her website as a vehicle for communicating with her fans and supporters about such things as sentencing reform and the bad prison food. By speaking to her constituents through her website, Stewart was able to establish a private connection with them in a very public forum.

While the company tried to distance itself from her name during the investigation, immediately after she was released, they introduced a new strategy of keeping Martha Stewart in the public eye every day (Carr, 2005). Two new television programs were scheduled on the air: a new syndicated daily daytime show entitled “*Martha*” and the NBC prime-time series “*The Apprentice: Martha Stewart*.” A new personalized *Martha Stewart* cookbook was also published. Clearly, Stewart resumed her public prominence and literally speaking, affirmed that her name, brand and company are inseparable. Apparently, she was determined to stay close to her company.

I always disagreed with the separation of the name and the brand and the person. To build on that name and brand is one thing. To divorce the name and the brand from the person was not an approach that I agreed with. (Carr, 2005, p. C1)

Stewart who used prison to restore and soften her image emerged into the public eye with a monumental comeback. While the company still faced financial uncertainties, public sentiment gradually began to swing in Stewart’s favor (Slater, 2006). For example, a group of fans used their website *savemartha.com* to get their message out. Fans purchased merchandise with slogans like “Free Martha,” “Save Martha,” and “Pardon Martha.” She attempted to cast herself as a new Martha Stewart, different from the perfectionist executive who was previously criticized in the press.

The public also seemed to exhibit a warm affection for the new Martha Stewart (Slater, 2006). A Gallup poll released in August, 2005 suggested, that she was actually more popular with a 52 percent favorable rating than she was years ago, before there was a hint of legal trouble (Carr, 2005). Once again she became a media celebrity. She was more open, saying “we are not going to avoid things” and took questions from a live audience every day on the daytime show, expecting the issue of her conviction to be raised (Carter, 2005, p. C1). She further stated: “It’s not off limits, let’s put it that way. I think it will come out naturally. It’s part of my life. It’s there. It’s not going to go away” (Carter, 2005, p. C1). Although Stewart has been limited in any executive capacity and barred from serving as a director of a public company for five years, it is unlikely that Stewart will end her role at MSO. In her current position as iconic founder of MSO, she still gets involved in all aspects of the business operation.

## **7. Conclusion**

The most effective way to manage a crisis situation is to communicate with the public as quickly as possible with accurate facts (Coombs, 2007; Fearn-Banks, 2007). On the day the insider trading scandal broke, however, Stewart barely responded to the accusations, leaving the media and public left to their own interpretations. The absence of communication suggested that she had something to hide. It appears that she simply was not aware of the seriousness of the scandal until she was charged with securities fraud, conspiracy, and making false statements on June 4, 2003. To further complicate matters, as the controversy began snowballing, she began to arrogantly avoid, rather than to responsibly manage, the crisis. It was as if she believed the crisis would disappear if she ignored it. Reber, Cropp and Cameron (2001) note that a non-response on the part of an organization points to guilt, whether the organization is guilty of allegations or not. Stewart’s reluctance to go public immediately and answer her critics, as well as respond appropriately to the negative media coverage, was damaging to both her personal and corporate images, and to her legal case (Jerome, Moffitt, & Knudsen (2007).

The absence of information from Stewart effectively lent credibility to her accusers. Simply put, she needed to demonstrate she was responsible and responsive to the expectations of her stakeholders. She had failed to offer a public apology for the wrongdoing in a timely manner. If she apologized for her false statements earlier, she might have saved her image and company reputation. In a broader context, she showed a lack of crisis leadership during her trial. Appropriate response strategies would not have only provided the stakeholders with accurate information, but also would have illustrated that she and her company had a strategy for moving beyond the crisis. The Stewart case shows the importance of an immediate and honest response to avoid harming the corporate image. In fact, it is Stewart’s celebrity status that drives the future of her company. Her iconic image can bring the brand down when there is personal misconduct. When she got more and more involved in the insider trading crisis, her company suffered along with her. Stewart’s painful lessons also teach us the value of an executive’s integrity and ethical behavior. Her personal misconduct did the most damage to the corporate image and reputation.

On a more subtle level, Stewart’s comeback after her prison release has given assurance to the stakeholders about the company’s future. In its annual report, the corporation has made a series of “forward-looking statements,” which include, for instance, getting back the sponsors that cancelled their contracts when Martha Stewart was convicted. It appears that part of the strategy for image restoration is to suggest that MSO has recovered from the crisis.

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Table 1: Martha Stewart’s Crisis Response Strategies

Date	Events	Response Strategies
6/7/2002	<i>The Wall Street Journal</i> writes an article breaking story about Martha Stewart’s ImClone stock sale. Her lawyer puts distance between Stewart and Waksal.	Differentiation
6/12/2002	Waksal is arrested and charged with insider trading. Stewart issues a statement repeating her assertion that she had a \$60 stop-loss order. She states that her transaction is entirely lawful.	Denial of any wrongdoing
6/18/2002	Stewart tries to resolve concerns and her new lawyer submits several documents to congressional investigators.	Corrective action
6/25/2002	Stewart appears on CBS’s <i>The Early Show</i> , and dodges the questions. She maintains her innocence.	Denial of any wrongdoing
7/25/2002	Stewart tells investors that she and her company should be considered separately.	Differentiation
10/3/2002	Stewart resigns from the board of the New York Stock Exchange.	Corrective action
6/4/2003	Stewart is indicted. Her lawyer suggests that she becomes a target for government prosecutors on account of her fame. Stewart resigns as chairwoman and CEO of her company but remains chief creative officer and a board member.	<ul style="list-style-type: none"> <li>• Shifting the blame</li> <li>• Attack the accuser</li> <li>• Corrective action</li> <li>• Differentiation</li> </ul>
6/5/2003	Stewart pays for a full-advertisement in <i>USA Today</i> and unveils a personal website in which she proclaims her innocence and insists she will fight to clear her name.	<ul style="list-style-type: none"> <li>• Denial</li> <li>• Corrective action</li> <li>• Attack the accuser</li> </ul>
3/5/2004	Stewart is convicted. She states that she will appeal the verdict and continue to fight to clear her name.	Diminishing
3/15/2004	Stewart steps down as director and chief creative officer of her company. Her new title is chief creative adviser.	<ul style="list-style-type: none"> <li>• Corrective action</li> <li>• Differentiation</li> </ul>
7/16/2004	Stewart receives a five-month sentence in prison. She asks the judge to remember all the good that she has done. She also apologizes and asks for forgiveness.	<ul style="list-style-type: none"> <li>• Bolstering</li> <li>• Apology</li> </ul>
10/ 8/2004	Stewart reports to Alderson prison in West Virginia.	Corrective action
3/4/2005	Stewart is released from prison. She resumes her public prominence.	Rebuilding
8/8/2006	Stewart agrees to pay \$195,000 for settling civil claims.	Corrective action

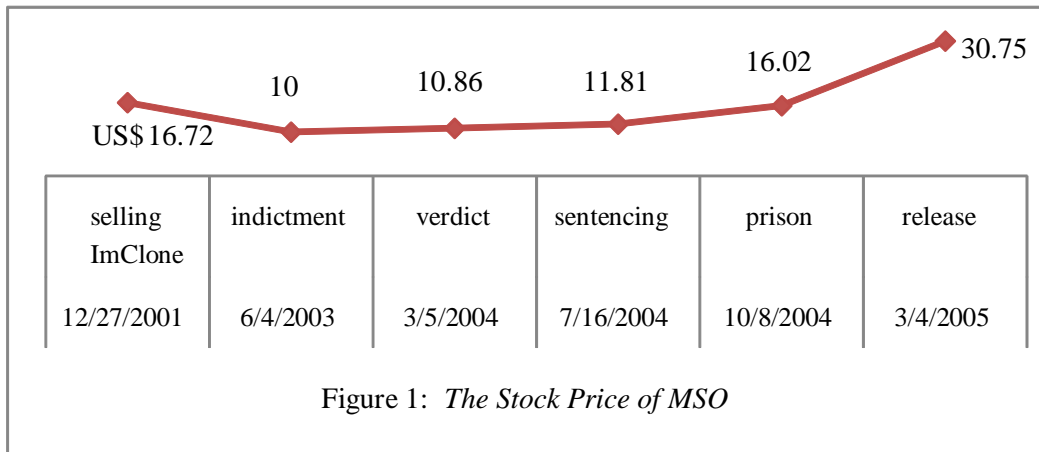


Figure 1: The Stock Price of MSO

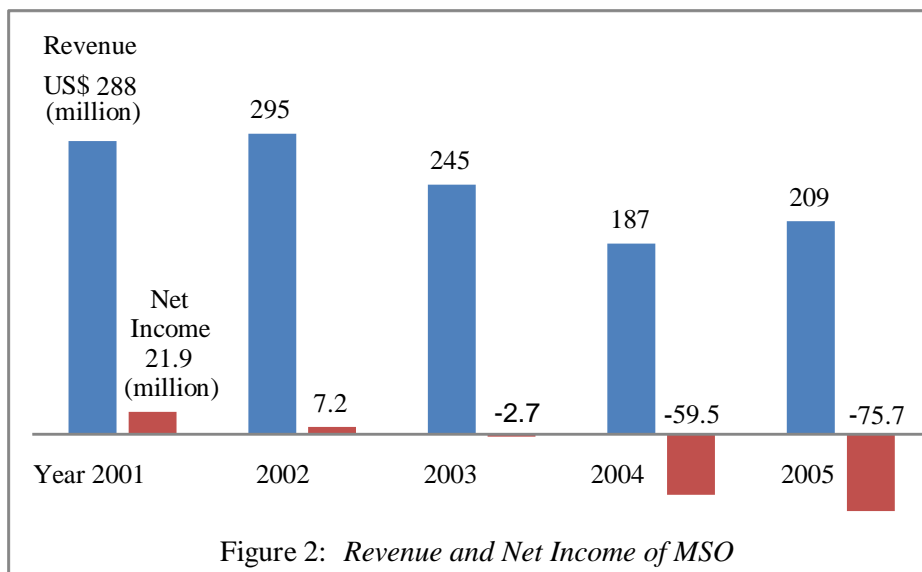


Figure 2: Revenue and Net Income of MSO