CEOs who misbehave more likely part of unethical corporate culture

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Chief executive officers who engage in unethical conduct for their own personal benefit tend to be part of firms that participate in other forms of corporate misbehavior, according to a new study from UT.

They also are more likely to lose their jobs and their firms are more likely to experience dramatic declines in value during market downturns, the research shows.

The study, conducted by Andy Puckett, UT associate professor of finance, along with Lee Biggerstaff, a UT doctoral candidate, and David Cicero from the University of Alabama, focuses on the tone at the top in companies, and indicates that a CEO's ethics and character drive an organization's culture.

It was recently published as a working paper by the National Bureau of Economic Research, an American private nonprofit research organization.

The study examined CEOs who personally benefited from options backdating—manipulating the date of a stock option given to executives to reflect a lower price and make them more valuable, maximizing the CEO's eventual payout. This comes at the detriment of shareholders and taxpayers.

The study showed that the firms led by these CEOs were more likely to overstate their profitability and engage in less profitable acquisition

strategies.

Puckett and the co-authors sampled more than 3,700 firms from 1992 to 2009 and classified 249 CEOs as systematic options backdaters—those with at least 30 percent of activity and at least two events that were classified as backdated.

The study found that while suspect CEOs were able to hide their true character during periods of economic expansion, they were more likely to lose their jobs during the ensuing market correction.

"It is comforting to know that ethics matter, and that in due time the character of unethical executives is revealed to the marketplace," Puckett said.

Researchers investigated corporate activities during the five-year period before and after a suspect CEO arrived at the firm. They found the prevalence of corporate misbehavior increased significantly following the CEO's arrival. Results from the study are concentrated in firms that hired their suspect CEOs from the outside.

"Our study highlights that an executive's ethical stature should be an important characteristic for boards to consider when hiring a new chief executive," Puckett said.

The study is under a third round of revision at the *Journal of Financial Economics*.

More information: www.nber.org/papers/w19261

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