The Consequences of Managerial Indiscretions:
Sex, Lies, and Firm Value*

November 16, 2016

Brandon N. Cline
Department of Finance and Economics
Mississippi State University
Mississippi State, MS 39762-9580
(662) 325-7477
brandon.cline@msstate.edu

Ralph A. Walkling
Center for Corporate Governance
Drexel University
Philadelphia, PA 19104
(215) 895-4920
rw@drexel.edu

Adam S. Yore
Department of Finance
University of Missouri
Columbia, MO 65211
(573) 884-1446
yorea@missouri.edu

Personal managerial indiscretions are separate from a firm's business activities but provide information about the manager's integrity. Consequently, they could affect counterparties' trust in the firm and the firm's value and operations. We find that companies of accused executives experience significant wealth deterioration, reduced operating margins, and lost business partners. Indiscretions are also associated with an increased probability of unrelated shareholder-initiated lawsuits, DOJ/SEC investigations, and managed earnings. Further, CEOs and boards face labor market consequences, including forced turnover, pay cuts, and lower shareholder votes at re-election. Indiscretions occur more often at poorly governed firms where disciplinary turnover is less likely.

JEL classification: G34, G39, K42
Keywords: managerial indiscretions, management quality, integrity, class action lawsuits, fraud, earnings management, corporate governance, managerial labor markets, director elections, CEO turnover, poor monitoring index

* We are appreciative of the helpful comments and suggestions from Malcolm Baker, David Becher, Sjoerd van Bekkum, Don Chance, Naveen Daniel, Madeline DeWoody, Eli Fich, Jacqueline Garner, Rachel Harry, Lucille Highlander, Jungmin Kim, Michelle Lowry, Alexey Malakhov, Stijn Masschelein, Tomek Piskorski, Laura Starks, Ed Van Wesep, David Yermack, Gary Zeune and particularly an anonymous referee. We also thank the conference and the seminar participants at the University of Amsterdam, the University of Alabama, Auburn University, Clemson University, Drexel University, Erasmus University, Louisiana State University, Massey University – Auckland, Massey University – Palmerston North, the University of Melbourne, Mississippi State University, the University of Mississippi, the University of Missouri, Nanyang Technological University, Northern Illinois University, the University of Technology in Sydney, the University of Western Australia, West Virginia University, the Chulalongkorn Accounting and Finance Symposium, the Ethical Dimensions in Business conference at Notre Dame, the Triple Crown Conference hosted by Rutgers University, and the annual meetings of the American Finance Association, Association of Private Enterprise Education, Eastern Finance Association, International Atlantic Economic Society, Financial Management Association, Midwest Finance Association, and the Southern Finance Association. We are thankful for the research assistance of Tricia Corcoran, Khaled Obaid, Valeriya Posylnaya, Chang Shu, and the University of Pennsylvania and the University of Chicago libraries. Yore gratefully acknowledges financial support from the NIU Division of Research and Graduate Studies and Notre Dame's Institute for Ethical Business Worldwide. All errors and omissions are our own.

1. Introduction

In 2012, the *Wall Street Journal* (WSJ) reported that Scott Thompson, Yahoo's CEO, lied about obtaining a computer science degree. In 2007, the WSJ reported that Chris Albrecht, the head of Time Warner's HBO unit, assaulted his girlfriend outside a Las Vegas casino following the Oscar De La Hoya v. Floyd Mayweather Jr. boxing match. These revelations no doubt were personally embarrassing to Mr. Thompson and Mr. Albrecht, but were they important for Yahoo and Time Warner? Specifically, do these personal indiscretions imply firm-level consequences and are signals of personal integrity important for firm value?

Despite the simplicity of this question, there are strong a priori arguments for and against an affirmative answer. Prior research indicates that illegal or opportunistic behavior affects firm value only when it results in significant legal penalties or affects the firm's contracting with counterparties in an unanticipated manner. Personal indiscretions, however, are not generally associated with significant legal penalties to the firm. The lingering economic question then is whether personal indiscretions of managers affect the firm's reputation in ways that impact counterparty transactions. If they do, it implies that private market forces work to discipline personal misconduct.

It is possible that there is no link between a manager's personal indiscretions and the firm's operations and business relationships. Previous research finds that environmental violations tend to result in substantial legal and regulatory costs, and that the revelation of an environmental violation is associated with a significant loss in share value, but not reputational losses [Jones and Rubin (2001)]. Presumably, environmental infractions do not significantly impact the firm's counterparties, i.e., its customers, suppliers, employees, and investors [Karpoff, Lott, and Wehrly (2005)]. Other examples of misconduct that do not correspond to reputational losses are minor regulatory violations and foreign bribery [Murphy, Shrieves, and Tibbs (2009); Alexander (1999); Cheung, Rau, and Stouraitis (2012); Karpoff, Lee, and Martin (2015)]. In this regard, personal indiscretions could be similar to environmental violations or foreign bribery, in that

they do not affect contracting with counterparties (i.e., no reputational effect). Thus, it is entirely plausible that a manager's personal life has no effect on firm operations and firm value. We term this the *separate affairs* hypothesis.

In contrast, there is the argument that there *is* spillover from a manager's personal indiscretions to job performance and firm value, which we term the *integrated affairs* hypothesis. The theoretical links for spillover effects are reputational losses to the manager and the related impact on counterparty transactions. Erhard and Jensen (2014) and Erhard, Jensen, and Zaffron (2014) argue that management's reputation for integrity is a factor of production. To the extent that these personal indiscretions signal low integrity, their revelation can impact the firm.[1]

Consider four potential sub-channels for this impact: First, we know that personal managerial guarantees can be important to the formation of profitable business relationships. Johnson, Karpoff, and Yi (2015), Cen, Dasgupta, and Sen (2015) and Cremers, Litov, and Sepe (2014) focus on how takeover defenses support such personal guarantees. Personal misconduct plausibly undermines the credibility of implicit and explicit agreements with strategic partners, employees, suppliers, customers, or owners of financial capital. A joint venture partner, for example, could decide to back out of a deal to co-locate a manufacturing facility if it infers that the cheating manager is more likely to act opportunistically. The indiscretion manager's firm would lose business, creating a reputational cost.

Second and related, the managerial indiscretion could increase the probability that the manager will be replaced, putting any implicit guarantees of the manager in jeopardy. As Shleifer and Summers (1988) argue, the business relationship between two firms is bonded in part by the manager's personal guarantees. If the manager leaves, that bond disappears and the exposed counterparty could be less willing to conduct business with the company.

[1] Spanos and Angelis (2016) summarize evidence that suggests that even events such as information systems security breaches may engender a lack of trust at certain companies.

Third, the indiscretion could signal a shift in the firm's culture to one that now implicitly condones opportunistic behavior. The likelihood of engaging in questionable behavior should decline with the manager's expected costs from being caught, costs which increase with enforcement actions by the firm. Thus, a firm's counterparty might infer from a managerial indiscretion that the firm does not penalize opportunistic behavior as strictly as previously anticipated and re-evaluate their business relationship with the company.

Fourth, the managerial indiscretion could reveal an increased likelihood that the managers are willing to sacrifice long-term relationships for short-term gains. The models of Shapiro (1983) and Klein and Leffler (1981) suggest that firms do not cheat their counterparties in equilibrium. An unexpected change in the costs and benefits of cheating, however, can make the benefits of short-term cheating increase relative to the long-term costs. Therefore, a managerial indiscretion could indicate the manager's benefits of cheating are higher than previously anticipated.

We argue that the revelation of an executive's personal indiscretion serves as a proxy for their lack of personal integrity and signals the value they place on their reputation. Under the *integrated affairs* hypothesis, this revelation decreases counterparty trust in the manager and the firm, which subsequently affects corporate relationships. Firm value is lowered either because a loss of trust damages the firm's relationships with strategic partners, financiers, and other stakeholders or because the indiscretion imposes direct costs as the firm adjusts to minimize the damage.

The importance of personal integrity to firm value has received little empirical attention. One reason for this is the difficulty in measuring the impact of integrity. It is challenging to identify executives with low integrity before corporate misdeeds are committed. In addition, measurements of losses around bad corporate behavior are intertwined with the impact of the acts themselves. An important literature focuses on allegations of fraud, shareholder lawsuits, and earnings management and it is generally

presumed that executives committing these acts have low integrity.[2] In that literature, the research design defines integrity by the malfeasance, making it difficult to establish a separate market reaction to the personal trait. For example, a firm typically sustains a loss in value when fraud is announced but it is difficult to know how much of the market reaction is due to a realization of low managerial integrity, the lack of firm-wide controls for misdeeds, the fraud itself, or its consequences. Moreover, we do not know the propensity for 'low integrity executives' to commit subsequent corporate misdeeds or if personal misdeeds concern their business partners, boards, or shareholders.[3]

A related stream of research addresses the relevance of the tone at the top within the organization. A recent survey of CEOs and CFOs by Graham, Harvey, Popadak, and Rajgopal (2016) indicates that senior management's behavior is a primary influence on corporate culture, with 85% of respondents stating that a poor culture elicits unethical or illegal activity within the organization. Consistent with these beliefs, studies by Davidson, Dey, and Smith (2015) and Biggerstaff, Cicero, and Puckett (2015) provide advances in linking integrity at the corporate level with other misdeeds.

Davidson et al. (2015) find that firms accused of fraud are more likely to employ executives who surround themselves with expensive luxury goods or have past legal infractions like traffic violations. These firms are also more likely to just meet or beat analysts' forecasts. Biggerstaff et al. (2015) find that CEOs attempting to pad their pay packages from the backdating of options are also more likely to engage in other corporate transgressions**.** These studies suggest executives engaging in serious corporate misdeeds might also act unethically in other ways. However, the identification of integrity is revealed through a significant and subsequent corporate event (fraud or backdated options) and the product, financial, labor market, and counterparty consequences to signals of personal integrity are not examined. In addition, backward

[2] For example, Karpoff, Lee, and Martin (2008) show that the market punishes firms indicted for corporate fraud well in excess of the stated legal penalty. Fich and Shivdasani (2007), along with Gande and Lewis (2009), study the incidence and impact of shareholder initiated class action lawsuits. DuCharme, Malatesta, and Sefcik (2004) and Teoh, Welch, and Wong (1998) examine the impact of earnings management on shareholder wealth.

[3] To be specific, we examine a pool of executives exhibiting *signals* of low integrity. For ease of exposition, we use the phrase 'low integrity executive.'

identification (implying integrity from a firm specific event) does not tell us whether the general population of low integrity executives is more likely to commit corporate offenses since the identification is conditioned on illicit corporate behavior.

In contrast to using corporate events, we identify low integrity executives as those accused of personal indiscretions, including allegations of dishonesty, substance abuse, sexual misadventure, or violence. Our sample consists of 219 unique indiscretions and 106 related observations. These personal indiscretions are, by construction, distinct from the operations of the firm, thereby permitting us to examine market reactions to the indiscretion separate from the reaction to the corporate malfeasance utilized in other identification strategies.[4]

We explore several research questions regarding the importance of a manager's personal integrity and its impact on firm value and performance. First, is there a financial market response that signals damage to the company's reputation following a personal indiscretion? Second, are there consequences in the product markets to these reputational losses? For example, the firm of an indiscretion executive could find it more difficult to maintain strategic partnerships or establish and maintain new stakeholder relationships. Third, do managerial indiscretions signal that accused executives are willing to abrogate contracts or act opportunistically? Specifically, low integrity executives could be more willing to defraud their business or financial partners, engage in conduct that becomes the target of litigation, or manipulate corporate earnings. Finally, what are the labor market consequences to this behavior for the indiscretion managers or their monitors?

We find that announcements of managerial indiscretions are associated with a significant decline in firm value and operating performance. At the revelation of an indiscretion, there is an immediate 1.6% loss in shareholder value that translates into an average loss of $110 million in market capitalization. When

[4] In addition, the 219 misdeeds in our sample are (arguably) more serious than those in Davidson, Dey, and Smith (2015). Twenty-one of their thirty-seven observations are traffic violations. While many of us have committed traffic violations, far fewer individuals have been accused of dishonesty, domestic violence, sexual misadventure, and drug charges. This is not to criticize Davidson et al. (2015), just to point out differences in the analyses. Indeed, a very interesting aspect of their study is that they find significant differences in non-fraud and fraud firms on a characteristic as simple as speeding tickets.

committed by the CEO, the loss in shareholder value is 4.1% or $226 million. The magnitude of the stock market losses suggests that investors react to more than just the monetary penalties associated with these events. Indeed, losses around the announcement of the indiscretion are consistent with at least two explanations encompassing: 1) the expected litigation, opportunity costs, or severance costs that arise as a direct result of the event and 2) the market value (reputational) adjustments to signals of low integrity. Following Karpoff and Lott (1993), we decompose the investor reactions into the components that reflect the direct monetary costs to shareholders and those that represent reputational damage.

To examine the channels through which the personal affairs of managers could be integrated into firm value, we examine changes in counterparty relationships in the firm's product markets. The prediction of the integrated affairs hypothesis is a decline in counterparty trust and deterioration of inter-firm relationships, as others are less willing to conduct business with a low integrity executive. Consistent with this, CEO indiscretions are associated with a significant decline in the acquisition of new major customers and joint venture partnerships, and CEO reputational costs are negatively and significantly related to the likelihood of obtaining a new major customer. Our results also indicate that operating performance suffers, as there is an abnormal decline in profit margin and return on assets (ROA). We further find evidence that indiscretion managers exhibit a willingness to expropriate stakeholders. Firms of indiscretion executives are significantly more likely to manipulate earnings or commit unrelated malfeasance that becomes the target of shareholder class action lawsuits or Department of Justice (DOJ) / Securities and Exchange Commission (SEC) fraud charges. Our results suggest that much of the effects we observe are attributable to reputational damage.

Finally, there is a meaningful labor market response to the indiscretion disclosures in our sample. CEOs are disciplined for their personal missteps, particularly for those indiscretions imposing large stock price hits or reputational damage. The risk of turnover increases substantially for CEOs committing indiscretions as the probability of CEO turnover rises by 41% following an indiscretion. Boards impose

financial discipline on the surviving CEOs, who see an average drop in salary and bonus of around $400k. In keeping with prior work on directors' career concerns [Cai, Garner, and Walkling (2009)], we find that corporate directors at indiscretion firms lose a small but significant percentage of shareholder votes; the magnitude is comparable to that observed when the firm is targeted by litigation. The effect is heightened for indiscretions committed by a member of the board. Interestingly, the loss in shareholder support is primarily related to the reputational damage associated with the indiscretion.

Our research is related to two streams of literature. The first is the literature examining the importance of top management as a factor of production. Existing work documents the role top management teams play in either creating or destroying shareholder value [e.g., Fama and Jensen (1983); Lang, Stulz, and Walkling (1989)]. The second associated stream of literature studies the importance of reputation and trust in economic exchange [Blau (1964); Tirole (1996); Jones and Rubin (2001); Karpoff, Lott, and Wehrly (2005); Karpoff, Lee, and Martin (2008)]. Mutual trust between two economic agents can reduce transaction costs if it mitigates the need for excessive contracting [Williamson (1975)]. Since not all outcomes are contractible, the consequences of managerial indiscretions can be substantial. Our work sheds additional light on the question of how trust facilitates contracting, production, and exchange. While these two areas of literature typically focus on activities at the corporate level, our paper contributes by documenting the link between non-business activities, integrity, and firm value. As far as we know, our paper is the first to examine shareholder wealth effects surrounding *ex ante* signals of low integrity revealed in an executive's personal life and how these signals impact corporate relationships in the product markets.

2. Hypotheses Development

2.1 The Separate Affairs Hypothesis

The literature investigating the importance of an executive to the firm concentrates on technical skills and experience [Rosen (1981); Bertrand and Schoar (2003)]. If these are the only relevant factors, then pure managerial talent is the dominating force in an executive's contribution to the company and

managerial indiscretions are immaterial for firm value. Viewed this way, managers are able to completely separate their personal and professional lives and only their raw abilities matter.

Kaplan, Klebanov, and Sorensen (2012) support the notion that only talent is relevant to firm value. Using a detailed sample of CEO ability and personality assessments from an executive search company employed by private equity firms, they find that VC and LBO clients value the 'hard' abilities of potential managers and that only quantitative skills impact the success of a private equity deal. 'Soft' skills, such as personal integrity or team-working ability, do not appear to improve performance and could even negatively affect outcomes. Brown, Goetzmann, Liang, and Schwarz (2012) also find evidence of "separate affairs" in the private equity industry. Even when hedge funds are not forthcoming about past legal infractions, investors are not dissuaded from chasing the highest returning funds. Frank and Goyal (2007) find that while compensation packages and education significantly explain the firm's capital structure, other personal traits exhibit no relation. These results imply that firm value is dependent largely on the skills and talents each executive brings to the firm.

Indeed, auditing standards explicitly exclude personal executive indiscretions in the analysis of non-compliance with laws and regulations. For example, guidelines by the American Institute of Certified Public Accountants state the following:

"*Noncompliance does not include personal misconduct (unrelated to the business activities of the entity) by those charged with governance, management, or employees of the entity*."[5] Also "*Illegal acts by clients do not include personal misconduct by the entity's personnel unrelated to their business activities.*"[6]

Our first hypothesis asserts that there are no spillover effects from personal to corporate actions. Implicit is the assumption that signals of low integrity do not imply professional misbehavior:

Separate Affairs Hypothesis – Personal managerial indiscretions have no bearing on firm value or performance.

[5] AU-C Section 250 Consideration of Laws and Regulations in an Audit of Financial Statements, par. 11.
[6] AU Section 317 Illegal Acts by Clients, par. 2.

2.2 The Integrated Affairs Hypothesis

In contrast are arguments suggesting that personal indiscretions *do* impact firm value and performance. First, the indiscretion can disrupt and distract the executive from optimal performance and create associated morale problems within the firm. In Becker's (1965) model, managers allocate time in a utility-maximizing manner and trade-off labor for productive outcomes with the rewards from private life activities. Thus, managerial indiscretions can adversely affect firm performance as the executive re-allocates time to private life activities and away from more productive endeavors at the firm. Also, boards often fire managers and a scandal increases the chance of dismissal [Ertugrul and Krishnan (2011)]. The potential or actual dismissal of any executive following an indiscretion can disrupt the firm's ongoing operations.

However, the primary channel through which personal indiscretions are likely to impact firm value stems from the importance of reputation and trust in economic exchange [Blau (1964); Tirole (1996)]. Tirole (1996) notes the importance of reputation and trust due to the inability to write complete contracts. Fukuyama (1995) describes trust as the set of reciprocal moral habits and obligations that are internalized, thereby reducing the propensity for wealth expropriation. As such, trust among agents can serve as an intermediary when unexpected issues arise, incentivizing individuals and corporations to engage in exchange that would not otherwise occur.

Shapiro (1983) argues that firm value depends on counterparty trust and that establishing a reputation for fair dealing is a costly signal. Supporting empirical evidence indicates that firm value declines when trust is violated at the corporate level [e.g., Murphy, Shrieves, and Tibbs (2009) and Karpoff, Lee, and Martin (2015)]. A number of other papers posit that managers' personal characteristics play an important role in establishing counterparty trust [e.g., Klein and Leffler (1981) and Shleifer and Summers (1988)], but we have little direct evidence that this is true. Indeed, as noted above, at least some existing

empirical work suggests that such concerns are superfluous and only the raw managerial talent matters to investors [Kaplan, Klebanov, and Sorensen (2012); Brown, Goetzmann, Liang, and Schwarz (2012)].

It is important to recognize that the executives who commit indiscretions *choose* to place themselves in the potentially distracting situation and this insight into their personal utility function reflects upon their character. Indiscretions can credibly signal that the executive does not highly value their reputation. As noted, Erhard and Jensen (2014) and Erhard, Jensen, and Zaffron (2014) argue that managerial integrity is a necessary factor of production. As the integrity of management becomes impaired, organizational performance suffers.[7]

Implicit in these statements is the assumption that personal indiscretions are correlated with a manager's willingness to act opportunistically or to abrogate implicit contracts. In particular, a firm's profit stream can rely on its (and its managers') reputational capital, since the price a firm is able to charge and the likelihood of repeated or future business are functions of this capital [Shapiro (1983); Klein and Leffler (1981); Karpoff and Lott (1993)]. Thus, firm value depends on how much the firm's counterparties (i.e., customers, investors, employees, suppliers) trust the firm not to cheat them. Shleifer and Summers (1988), along with recent work by Cen, Dasgupta, and Sen (2015), Johnson, Karpoff, and Yi (2015), and Cremers, Giambona, Sepe, and Wang (2015), use this idea to show that shareholders benefit from stable, long-term relationships.

The integrated affairs hypothesis holds that personal indiscretions matter because the firm's counterparties are less willing to do business with the firm if they believe their expected costs have increased. This could result from an expectation of being cheated or an expectation that the firm will not fulfill some explicit or implicit agreement. As a result, investors anticipate that this reassessment will lead to declines in operating performance and firm value suffers. In this scenario, contracts and controls

[7] The authors utilize the analogy of removing spokes from a wheel to demonstrate the impairment of integrity. A complete wheel does not guarantee a fast bike, but the removal of spokes from the wheel impairs the performance of such a machine. An organization where top management does not maintain integrity, i.e., keep its word, will not achieve its full potential in the context of its employees, suppliers, or customers due to a lack of trust among agents. Such an environment would require excessive contracting and high residual losses.

become substitutes for trust and additional transaction costs are incurred [Williamson (1975)]. Empirical research documents that a lack of trust among economic agents can result in severe penalties in the marketplace [Atanasov, Ivanov, and Litvak (2012); Bauer and Braun (2010); Chemmanur and Paeglis (2005); Karpoff, Lee, and Martin (2008); Yermack (2006)]. Although each of these studies examines business-related activities and not personal indiscretions, the implication is that negative signals regarding the character and integrity of management adversely affect firm value.

Graham, Harvey, Popadak, and Rajgopal (2016) report that an overwhelming majority (76%) of CEOs and CFOs surveyed indicated that trust was a key factor in determining the effectiveness of culture. Over 50% of these same executives stated they would not acquire another firm at *any* price if the target company did not have an effective culture. This evidence is consistent with Murphy, Shrieves, and Tibbs (2009) who find that product market discipline is most severe in the wake of related-party financial misconduct. It is also consistent with Karpoff, Lee, and Martin (2008) who find that the reputational penalties for fraud are increasing in the firm's dependence upon implicit contracts. If managerial indiscretions signal a duplicitous manager, then these allegations should lead to a decline in counterparty trust and difficulty in obtaining and maintaining meaningful business relationships.

Anecdotal evidence also suggests that personal reputation impacts firm value. Stephen McClellan, a 32-year Wall Street veteran and 19-year *Institutional Investor* All-American analyst notes:

"a critical part of the investment appraisal and company evaluation process is gauging management effectiveness, quality, character, and values. I am put off by executives with a litany of ex-wives, messy public divorces, marriages to bimbos, visits to strip clubs, [or] heavy drinking." [McClellan (2008), emphasis added][8]

Integrated Affairs Hypothesis – Personal indiscretions are associated with losses in firm value, operating performance, and strategic partnerships or stakeholder relationships.

[8] Similarly, when Veritas Software Corp. disclosed that its CFO, Ken Lonchar, falsified his personal credentials there was immediate concern in the marketplace for the firm itself. Merrill Lynch analyst Scott Phillips downgraded Veritas after the Lonchar disclosure. "Our first concern is that the CFO's falsification of his educational credentials could suggest the financials are suspect" [Reuters (2002)]. In another example, Maryland U.S. Attorney Thomas DiBiagio noted during the prosecution of alleged corporate looter, Nathan Chapman, that "if their life is a lie, it's not confined to their personal life. If they are lying to their wives, there's huge potential they are also lying to their colleagues, their board of directors and potentially their auditors" [O'Donnell and Farrell (2004)].

2.3 Shady Firm-Shady Manager Optimality

CEO selection is not an exogenous process, but rather a choice conditioned on the industry characteristics in which the firm resides [Datta and Rajagopalan (1998)]. Executives charged with corrupt acts at their firms often claim they were striving to maximize firm value.[9] Indeed, it is entirely possible that some firms believe it is optimal to hire a shady manager because of the nature of their business. For example, Mironov (2015) finds that firms with criminally inclined CEOs outperform their more honest counterparts in corrupt environments. Thus, a penchant for duplicitous behavior could be viewed as an asset in certain "shady" industries. It is possible, or likely, that some types of firms purposefully hire shady managers and optimally have a high likelihood of restatements, lawsuits, or SEC actions. Hence, the observation that personal indiscretions are associated with corporate offences is also consistent with some firms viewing hiring shady managers as optimal. In our sensitivity tests we are careful to recognize and explore this possibility.

3. Data

3.1 Sample Construction

To test our hypotheses, we construct a sample of managerial indiscretions and a control sample. The first is a sample of alleged offenses in the personal environments of executives occurring between 1978 and 2012. The cases are identified using targeted search strings in the *Factiva*, *LexisNexis*, and *ProQuest* news retrieval services.[10] The announcement date is the date of the first news article mentioning the event. The sample is arranged along four categories of indiscretions: *sexual misadventure*, *substance abuse*, *violence*, and *dishonesty*. *Sexual misadventure* refers to extra-marital affairs, senior-subordinate inter-office romances, accusations of sexual harassment, and the like. *Substance abuse* cases are reported DUIs, illicit

[9] See Bartov, Givoly, and Hayn (2002), and Murphy, Shrieves, and Tibbs (2011) for the ex-ante shareholder wealth motivations for earnings management or malfeasance.

[10] The following is an example *LexisNexis* search string that searches for *dishonesty*: (CEO OR COO OR CFO OR executive OR president OR chairman OR director) w/p (lied OR lie OR credentials OR resume OR dishonest OR plagiarism OR falsification OR falsified OR padded resume OR lied on resume).

drug arrests, etc. *Violence* refers to instances of domestic violence, sexual battery, rape, or assault.[11] *Dishonesty* cases include falsifying credentials, perjury, and plagiarism. Typical examples of each of these indiscretion types are provided in Table 1.[12]

Sexual misadventure and *dishonesty* allegations represent the breaking of explicit or implicit agreements in the executive's personal or professional environment, while *substance abuse* and *violence* are violations of the executive's legal obligations. All of these activities are explicitly tangential to the operating and financial decisions of the firm and to the normal business-related activities of the executive. Items such as fraud, embezzlement, excessive perks or pay, or securities violations, which might also signal the integrity of the executive, are specifically excluded since these could potentially be undertaken to further the goals of the organization and can have an ambiguous impact on future performance. Moreover, each of these business related events is likely to be associated with wealth changes to the firm regardless of the impact of managerial integrity since they present tangible losses in cash flow or increases in risk.

We identify 437 potential indiscretion observations involving C-level executives (CEO, COO, CFO), division heads, vice presidents, or board members. After screening for complete data, we retain a final sample of 219 distinct indiscretions involving 195 unique executives (a handful are within-sample repeat offenders).[13] Since the executives in our sample frequently have positions at multiple firms (e.g., a CEO with an outside directorship), we have a total of 325 unique executive-firm-year observations that are summarized in Table 2, Panel A. The existence of multiple roles for some of our executives introduces

[11] Some *violence* acts, such as sexual battery or rape, might also be classified as *sexual misadventure*. The distinction is made here since these cases are criminal in nature as opposed to the strictly personal or civil complaints involved in the misadventure category.

[12] Indiscretions are categorized according to the primary offending action, but some instances involve multiple indiscretion types (e.g., violence resulting from substance abuse). There are 26 indiscretions that involve two categories and three that involve three categories, but many of these had a clear dominant categorization. Out of the 325 sample observations, 16 observations (11 primary firm and 5 secondary firm) required some judgment regarding classification category. A common example among these 16 cases is an extramarital affair where violence or drug use was also alleged. For these cases, we classify each as sexual misadventure. All tests were re-examined with these observations removed and using the alternative classifications for these observations. The results are qualitatively unchanged and are reported in Internet Appendix tables A and B.

[13] Sixty-two observations were excluded because there was insufficient information to substantiate the alleged indiscretion for our analysis (e.g., no specific date from the news stories, details of the case are unclear, etc.). Eighteen were excluded because the executive was no longer at the firm when the event was reported (e.g., Thrifty Payless was spun-off from K-Mart in the midst of an alleged affair involving Thrifty's CEO). Six observations were excluded because they were not completely unrelated to company business. Fourteen were eliminated because the company was not yet publicly traded at the time of the announcement. The remaining 12 were excluded because they had insufficient information on CRSP and COMPUSTAT to conduct our primary tests.

within-indiscretion variation that allows us to further examine the importance of certain firm-specific characteristics (e.g., executive title, method of disclosure, founder status). Out of the 325 observations, we classify 219 as *primary firm* and 106 as *secondary firm* observations to indicate the executive's principal place of employment. Our paper's conclusions are unaffected if we restrict the analysis to the 219 primary firm observations.

3.2 Sample characteristics

We detail the incidence of indiscretion types in Panel B of Table 2. About 47% of the indiscretions (153 of 325) involve sexual misadventure. Dishonesty accounts for 33% of the observations, while substance abuse and violence account for 11% and 9%, respectively. Panel C reveals the initial source of public information about the alleged indiscretion. About 22% of our observations are disclosed through press releases by the executive's firm, and the remainder are revealed through legal filings (37%) and media reports (41%). Insider whistleblowing appears unlikely for the vast majority of our observations as they involve public announcements arising from criminal actions, such as substance abuse and violence, or sexual misadventure announced through legal actions. In unreported results, we find that only 4% of our sample observations result from an internal tip or company investigation.

Panel D shows the roles of the 195 unique executives accused of indiscretions. At their primary firms, about 11% are directors only, 46% are CEOs, and the remaining 43% are other subordinate executives (i.e., other C-level officers or division heads). The last column reveals that the percentages of director, CEO, and subordinate observations in the full sample are 37%, 35%, and 29%, respectively.

3.3 Personal Characteristics and Outcomes for Indiscretion Executives

Table 2, Panel E documents the participants, characteristics, and outcomes according to the type of alleged indiscretions. The executives charged with indiscretions are, on average, about 52 years old and almost exclusively male (96%). The probability of turnover increases significantly for executives charged with indiscretions as 36% of our 219 primary firm executives are terminated within 30 days of committing

an indiscretion. In Panel F of Table 2, we distinguish the types of costs associated with an indiscretion. We collect data on direct costs imposed on the firm because of the indiscretion, including legal costs from defending the executive, payouts to plaintiffs in a settled lawsuit, opportunity costs due to the unavailability of the executive, and severance costs associated with terminating the executive as a result of the indiscretion.

For the legal expenses, we conduct a thorough review of the company's SEC filings around the announcement of the indiscretion for all 325 of our indiscretion observations. If the litigation costs are deemed material, they are required to be disclosed in the 10-K or 10-Q filings under the section "Legal Proceedings" by Item 103 of Regulation S-K. Occasionally, an executive's personal legal defense is granted as a form of pay and is listed as an item under "Other Compensation," so we search corporate proxy statements for evidence of such disclosures. Since it is up to the company to determine what constitutes a material legal expense, we also search *Factiva*, *LexisNexis*, and *Google* for news of litigation against the executive, firm, or both. We follow up any mention of a lawsuit with the clerk of courts, circuit court, or the U.S. Courts' PACER (Public Access to Court Electronic Records) service to get details on local, regional, or federal court cases. We separately track any disclosed legal expenses and corporate settlements to the plaintiffs. The incidence of each of these events is reported at the top of Panel F. Seventy-four indiscretions (23% of the sample) elicit some sort of lawsuit naming the company and fifty (15%) of the cases involve the company mounting a material legal defense. For those firms disclosing the dollar amount of their legal exposure, settlements and legal fees average a total of $2.2 million.

Time away from the job also represents an opportunity cost to shareholders. Accordingly, we search news stories, SEC filings, court records, and state statutes for criminal penalties to determine how many days an indiscretion took the executive away from the office. The observable opportunity costs largely fit into the categories of sensitivity training and rehab, suspension, and time spent in jail or court proceedings. Among the 325 indiscretions, 65 (20%) evoke some form of measureable opportunity cost. The average

time lost is approximately 28 days and the average cost is $27,465. We note that the relatively small daily compensation for corporate directors pushes this figure towards zero. Obviously, this time away is difficult to value. As a proxy, we use the daily pay rate for the executive from the disclosed salary or retainer at the firm.

About 10% (32) of the executives resigning from their positions as a result of the indiscretion are provided severance pay in conjunction with their turnover. To tabulate these costs, we again search the corporate proxy statements and news stories for evidence of severance packages. For these 32 executives, the average severance pay was just over $3.6 million. Approximately 7% of the sample was fired for cause. While not used in our primary tests, we note that most (5% out the 7%) executives that were "fired for cause" were forced to forgo unvested stock and option grants. Similarly, some executives retained forfeited their annual bonus or faced other monetary penalties for their actions, which mitigated the costs facing the firm in light of an indiscretion revelation. We search corporate proxy statements for evidence of these forfeitures of compensation and collect any instances thereof. The average forfeited compensation is approximately $8 million.

The disclosure of an indiscretion has implications for not only the tangible dollar losses mentioned above, but also the value of the firm's reputation when dealing with its customers, suppliers, employees, and investors. Using standard event-study methods [Brown and Warner (1985)], we assume that the firm's stock price reactions in the three days surrounding the announcement date represent an unbiased forecast of the total expected costs facing shareholders as a result of the indiscretion. Following Karpoff and Lott (1993), we partition the total cost of the indiscretion into its direct monetary or disruption cost component (*disruption cost*) and its reputational component (*reputational cost*).

$$\textit{Total Cost of Indiscretion} = \textit{Market Value Loss at Announcement} \quad (1)$$

$$= \textit{Disruption Cost} + \textit{Reputational Cost} \quad (2)$$

The *market value loss at announcement* is the abnormal total dollar return from the CRSP value-weighted three day cumulative abnormal return (*CAR*), multiplied by the pre-event market capitalization of

the firm. The disruption cost is defined as the summation of all of the direct monetary and opportunity costs associated with the indiscretion. The reputational cost is the difference between the total cost of the indiscretion and the disruption cost. The statistics at the bottom of Panel F of Table 2 report the aggregate disruption cost and the average residual reputational cost. For each firm we also calculate the ratio of disruption costs or reputational loss relative to sales and report the average across all firms. The average disruption cost is approximately $600 thousand and represents only 0.19% of sales. In comparison, the mean reputational cost is around $109 million and represents 6.3% of sales. This provides preliminary evidence that the reputational damage contributes significantly to the loss in value of the average indiscretion firm. This is consistent with Karpoff and Lott (1993) in the corporate setting who show that the reputational losses surrounding fraud prosecutions account for over 93% of the market reaction as opposed to the direct court penalties or fines.

3.4 Indiscretion and Panel Data Sample Characteristics

To investigate the characteristics and impact of managerial indiscretions relative to the population of publicly traded firms, we assemble a panel dataset of indiscretion and non-indiscretion firms from the universe of companies listed in the COMPUSTAT / EXECUCOMP / RiskMetrics (IRRC) merged database with complete data for our tests. Since we require data on the governance structure of the firm from RiskMetrics (IRRC), whose coverage begins in 1996, we restrict this sample to the 1996-2012 time period. After imposing these restrictions we have a total of 15,950 firm-year-observations.

Table 3 presents the summary statistics for our indiscretion and panel datasets. The mean (median) level of sales and market capitalization at our indiscretion firms are $21.4B ($2.2B) and $23.5B ($2.4B), respectively. The average (median) Tobin's Q ratio is 2.25 (1.47). The typical firm in our indiscretion sample is profitable on an operating basis, with a mean (median) operating return on assets (OROA) of 6.4% (11.1%). These figures are comparable to those found in other corporate work [Yermack (1996, 2006); Coles, Daniel, and Naveen (2008)]. Strikingly, 59% of the sample observations are classified as having

occurred at a family managed firm. This is significantly higher than the incidence of family managed firms found in typical studies of U.S. industrial companies and meaningfully larger than the proportion in our panel dataset [Anderson and Reeb (2003) report family ownership at about one-third of S&P 500 firms].[14]

3.5 Association between Managerial Indiscretions and Observable Firm Characteristics

We begin our regression analysis by examining whether certain observable firm characteristics are associated with indiscretion announcements. Arguably, the incidence of managerial indiscretions is endogenously related to the firm characteristics we study and establishing causality is problematic. Therefore, we view the results in this section suggestive of associations rather than definitive determinants.

In Table 4, we report the results of logistic regressions using the 15,950 panel data observations. The dependent variable in models (1) – (4) is a (0,1) indicator of whether any indiscretion, a CEO indiscretion, or a non-CEO indiscretion occurs. Our models also include governance characteristics such as CEO and director ownership, CEO age, CEO tenure, and family managed status.[15] We also add standard firm controls such as firm size, firm age, industry-adjusted ROA, industry-adjusted Tobin's Q, leverage, and capital expenditures. All control variables are computed using the most recent fiscal year-end data immediately preceding the indiscretion announcement. Each model includes industry and year fixed-effects and the reported p-values are computed using robust [Rogers (1993)] firm-clustered standard errors.

To further examine whether corporate governance mitigates the occurrence or impact of managerial indiscretions, we examine four variables suggested in the literature, which we sum to form our 'poor monitoring index,' constructed as:

$$\textit{Poor Monitoring Index (0,4)} = \textit{Non-Independent Board (0,1)} + \textit{Large Board (0,1)} + \textit{Busy Board (0,1)} + \textit{Hand-Picked Board (0,1)} \quad (3)$$

[14] We identify family firms in several ways. First, we identify family firms using the data collected by Anderson and Reeb (2003) and made publicly available on their website. Second, we examine the titles held by the members of the top management team and note whether any of them hold the title of founder. We also classify any firm as a family firm whenever a managing executive's name is the same as the firm's name, as well as those instances where an executive's tenure precedes the listing of the firm on CRSP and COMPUSTAT by at least three years. Finally, we review each news story to see whether the firm itself is founder managed or family controlled.

[15] Anderson, Duru, and Reeb (2009) document that family-led firms are associated with greater information asymmetry, larger agency costs, and lower firm performance for all but the most transparent family firms, while Anderson, Martin, and Reeb (2015) find that over 70% of federal enforcement actions for fraud occur at family firms. Arguably, given their substantial personal investment in the company, corporate founders make less of a distinction between themselves and their firms. Consequently, founders might be especially prone to engage in indiscretions or have boards that are more likely to overlook transgressions.

where *Non-Independent Board (0,1)* takes on a value of '1' if more than 50% of the outside directors are not classified as independent, *Large Board (0,1)* is set to '1' if the board is larger than the median board in RiskMetrics (IRRC) in the year, *Busy Board (0,1)* takes on a value of '1' if more than 50% of the outside directors hold three or more board seats, and *Hand-Picked Board (0,1)* is set to '1' if more than 50% of the outside directors have tenures less than that of the CEO.[16]

The results of the control variables are reflective of prior research on corporate malfeasance. Most notably, the poor monitoring index is significantly positively related to the propensity for a managerial indiscretion in each of the models. The marginal effects imply that incrementing the index by one provision magnifies the association with the disclosure of an indiscretion by 10.1%.[17] Consistent with founders intertwining their personal and professional lives, we observe indiscretions announced significantly more often at family managed firms and the economic impact is large. The marginal effects imply a sizeable 41.6% increase in the partial correlation with an indiscretion.[18] In several of our models, we also find that indiscretions are more likely to occur at larger firms and those managed by new CEOs. The significant coefficient on size is consistent with greater agency issues at larger firms or larger firms attracting increased media attention.

Work by Kedia, Luo, and Rajgopal (2016) shows that a culture of organizational non-compliance is associated with other forms of malfeasance.[19] We therefore test whether the incidence of managerial indiscretions is systematically related to industry characteristics. Using the data from Kedia, Luo, and Rajgopal (2016), we first identify industries in which it could be optimal to hire managers with low

[16] As illustrative examples of the importance of these variables, see Weisbach (1988) and Dahya and McConnell (2005) [board independence], Yermack (1996) [board size], Core, Holthausen, and Larcker (1999) and Fich and Shivdasani (2006) [busy boards] and Coles, Daniel, and Naveen (2014) ["hand-picked" directors].

[17] The marginal effect at sample means is 0.14%. Given that the unconditional probability of an indiscretion is 1.38%, this represents a 0.14%/1.38% = 10.1% increase.

[18] Similarly, the marginal effect of 0.574% implies a 0.574%/1.38% = 41.6% increase in the unconditional probability of an indiscretion.

[19] The authors identify "deviant organizations" (as opposed to "deviant managers") as those with a history of non-compliance and enforcement activities from the Food and Drug Administration, Department of Justice, Federal Trade Commission, Mine Safety and Health Administration, Occupational Safety and Health Administration, Office of Federal Contract Compliance Program, Wage and Hour Division, and the Environmental Protection Agency. They illustrate that these deviant organizations exhibit a propensity for financial misreporting.

integrity, by categorizing industries where firms have a propensity for non-compliance with Federal rules and regulations. Everything else equal, firms in these "shady industries" could find it optimal to hire "shady managers" who are willing to skirt the rules in the interest of maximizing profits. We classify industries with regulatory non-compliance scores greater than the median as a *shady industry (non-compliance)*.[20] As an alternative, we utilize Transparency International's Bribe Payers Index (BPI), which captures the perception of foreign bribery by industry [Karpoff, Lee, and Martin (2015)]. Since lower values on this index denote greater corruption, we identify industries with grand bribery scores less than the median as a *shady industry (BPI)*. Roughly half of our indiscretion announcements originate in shady industries by either of these definitions.[21]

In models (5) and (6) of Table 4, we include the shady industry indicators as an additional explanatory variable. We are mindful to the possibility that, even if indiscretions are no more likely in these industries, shady firms could try to withhold their disclosure. Therefore, estimations using the indiscretion indicator as the dependent variable could bias against finding a result. To address this, we limit our dependent variable to those indiscretions that are reported by an outside disclosure source (*outside disclosure indiscretion*), such as the media or law enforcement, under the assumption that these entities are not beholden to the firm. We do not observe a positive association with the shady industry indicators, which makes the shady firm-shady manager conjecture a subsidiary concern.[22]

4. The Wealth and Accounting Impacts of Managerial Indiscretions

4.1 Managerial Indiscretions and Firm Value

Table 5 reports event-study evidence to examine the impact of managerial indiscretions on firm value using three-day (-1,+1) and five-day (-2,+2) *CARs* surrounding the announcement date. For the full

[20] We thank Kedia, Luo, and Rajgopal (2016) who graciously provided their data.
[21] Although the results are consistent with both measures, we have some concern for using either the non-compliance or BPI measures as the sole method of identifying 'shady industries.' We take comfort that such differing methodologies for classifying shady industries, which each likely identify some facet of shadiness, yield similar results.
[22] The shady industry indicator is negative and significant when including company disclosed indiscretions, consistent with our concern of non-disclosure.

sample of 325 observations, the mean (median) three-day *CAR* is -1.62% (-0.58%). This translates into a $110 M ($2.5 M) evaporation in market capitalization at the disclosure of the indiscretion. The results are similar when considering five-day windows. All values are statistically significant at the 1% level.

If personal executive behavior impacts firm value, the signal should be strongest at the executive's primary firm and for the CEO given their importance. Using the 219 primary firm observations detailed in Table 1, the mean and median three-day abnormal returns at the executive's primary firm are significantly negative, -2.34% and -1.12%, respectively. The announcement returns are also significantly more negative for CEO indiscretions. The mean (median) three-day *CAR* for the 113 CEO observations is -4.06% (-1.84%), implying an average shareholder wealth loss of $226 M. The *CAR* for the 212 other executives and directors is an insignificant -0.32% (-0.37%).

Dramatic wealth changes at the announcement of the indiscretion could anticipate executive turnover or induce the board to dismiss the executive. Alternatively, executive turnover might signal to the market that the problems are more serious or the reputational damage is more severe. In Table 2, Panel E, we report that the board removes the executive from their primary firm position at the disclosure 36% of the time. Not surprisingly, turnover is less for executives in a secondary role. In table 5 we see that executive turnover is 27% (or 89 of 325) of the full sample of primary and secondary firm observations. Interestingly, in Table 5 the wealth losses associated with these turnovers are statistically comparable to those cases where the executive is retained (-2.32% v. -1.35%, difference p-value = 0.294). In both subsets, however, the wealth losses are significantly negative.

When stratifying by indiscretion type in Table 5, the three-day *CAR*s are significantly negative for three of the four categories of alleged indiscretions. The magnitudes of losses, however, differ markedly across the categories. Sexual misadventure is associated with losses of about 0.63%, while violence and dishonesty are associated with losses of 1.67% and 2.84%, respectively. The abnormal returns associated with substance abuse are not statistically significant. If trust in economic exchange is an important factor

of production [Triole (1996); Erhard, Jensen, and Zaffron (2014)], then cases of violence and dishonesty are perhaps the most damaging to the firm. In fact, dishonesty, the indiscretion category that arguably reflects the most upon the reputation of the executive, is associated with the most negative returns.

Finally, we bifurcate the sample according to whether the indiscretion is announced in a shady industry. The shady firm-shady manager conjecture suggests announcements in these industries to be muted to the extent that disreputable behavior is anticipated. Consistent with this argument, using the non-compliance measure of shady industry, the 161 disclosures in shady industries are associated with mean (median) losses of -1.11% (-0.34%), while the 164 observations in the non-shady industries experience sharper losses of -2.12% (-1.1%). The abnormal returns are significantly different from zero (but insignificantly different) for both shady and non-shady industries. In addition, the announcement returns are similar in magnitude to each other using the BPI-based measure. Although this insignificance between categories does support the shady firm-shady manager conjecture, it also demonstrates that our primary conclusions from the announcement returns are not driven by these observations.

Table 6 contains a regression analysis linking characteristics of indiscretions and types of executives with abnormal announcement returns. Consistent with our univariate results, we find that abnormal returns are significantly more negative for indiscretions involving the CEO and for public dishonesty. In the first model, CEO indiscretions are associated with returns that are 3.6% lower than those for non-CEO indiscretions, and those involving dishonesty experience returns that are 3.9% lower than the other indiscretions.

As discussed under the integrated affairs hypothesis, the decline in firm value reported in the univariate *CARs* could be related to the executive getting caught, the strength of the integrity signal from the indiscretion, or both. To distinguish between these two potential effects, we examine the relative importance of direct and reputational costs as components of the total abnormal return. By construction, reputational costs are measured as abnormal returns minus the direct costs. Consequently, the sensitivity of

the total announcement return to the direct costs of the indiscretion demonstrates the relative importance of the direct disruptive costs versus reputational costs.

The coefficient on direct disruption costs is insignificantly related to the returns around the announcement of an indiscretion for the overall sample in model (1). This suggests that the direct costs associated with the distraction are not a primary predictor of the total loss in firm value. Instead, the resulting implication is that the primary cost associated with the decline in firm value is attributable to reputational capital lost.[23]

Although all of our indiscretions probably impose some reputational damage, reputational costs are likely to vary according to the indiscretion type. For example, cases of dishonesty are more likely to tarnish the firm's reputation for honest dealing. Sexual misadventure, on the other hand, could entail more direct costs associated with the indiscretion. In models (2) through (5), we estimate separate models for each indiscretion category to examine the impact according to indiscretion type and the conditional effect of the direct versus reputational costs on firm value since both types of costs could be at play depending on the nature of the indiscretion.

We find that disruption costs are a significant predictor for the returns around the announcement of cases of alleged sexual misadventure. The coefficient on disruption costs in model (2) suggests a 1% increase (approximately a one standard deviation move) in the ratio of direct costs to sales for sexual misadventure is associated with an announcement return that is lower by 4.9%. Thus, a significant portion of the returns for this category is explained by direct costs. However, disruption costs are insignificant for substance abuse, violence, and dishonesty. Overall, these results indicate that both costs are at play, but for the majority of indiscretion types (substance abuse, violence, and dishonesty), reputational costs are the dominant factor.

[23] In the remaining tables of the paper, since our models are not predicting *CARs*, we include both the direct disruption costs and the reputational costs associated with a managerial indiscretion.

As discussed in section 2.3, the market could anticipate that in some industries it can be optimal to hire managers with less integrity. It is possible that some managers are hired with the expectation of cutting corners. In these industries the reputational impact of an indiscretion could be less severe since indiscretions are partially anticipated by shareholders. In this situation, direct costs would play a larger role in explaining the market reaction to an indiscretion in shady industries.

Models (6) through (9) examine indiscretions in shady and non-shady industries, respectively. Using the non-compliance measure, CEO indiscretions for each sample are negatively and significantly related to the announcement *CARs*; however, point estimates on CEO indiscretions indicate that the impact of an indiscretion committed by a CEO in a non-shady industry is 2% larger than one committed by a CEO in a shady industry. This is consistent with market anticipation of shady behavior in industries associated with non-compliance. The coefficient on disruption costs is insignificantly related to the returns around the announcement of an indiscretion for firms operating in the non-shady industry environment. However, the direct disruption costs are a significant negative component of the returns for firms operating in shady industries. For these shady industry firms, a 1% increase in direct cost is associated with an announcement return that is lower by 1.9%. Perhaps most compelling, dishonesty is insignificant for the shady industry sample, but remains negative and significant for the non-shady industry firms. The results are similar bifurcating by the BPI version of shady industry. Thus, investors react more negatively to indiscretion announcements in industries where having an impeccable reputation is more likely to be expected. In contrast, investors of firms in industries associated with bending the rules react more to the direct costs of the indiscretion rather than the signal of managerial integrity.

As noted, the announcements of our indiscretions are primarily driven by external events (e.g., arrests). Our sample also contains 63 confounding announcements (e.g., earnings guidance, new product

announcements, etc.) released during the announcement period in which the indiscretions are disclosed.[24] The results are qualitatively unaffected if the confounding events are removed;[25] however, in these tests, we *choose not* to exclude potentially confounding events. Rather, we identify these instances with an additional control variable labeled *Confounding Event*. Since the indiscretions we measure are personal in nature, a structural connection to confounding corporate events seems unlikely. However, we retain these observations due to the possibility that firms manage the grouping of news events, and this sample provides additional insight into the motives of top management.

In model (1) of Table 6, the full sample model documents a positive bias to the confounding observations of around 2%. Provided that positive shocks do not systematically arrive at firms disclosing indiscretions more often than negative ones, this evidence is consistent with purposely releasing positive information at the time the indiscretion is announced, suggesting further support for the integrated affairs hypothesis. However, since we do not have a benchmark for the 'typical' market reaction to similar confounding events, the result should be interpreted with caution.

Overall, the evidence presented in Tables 5 and 6 suggests that on average the market response to a managerial indiscretion is significantly negative.[26] Table 6 further reveals that for the full sample, and most indiscretion categories, the market response is not significantly related to the direct cost of getting caught. The implication is that a significant portion of the loss in firm value is due to the reputational capital lost when an indiscretion is announced. To the extent that investor reactions contain expectations of lost business, this is consistent with prior work which finds that the financial markets anticipate product market

[24] The 63 confounding events in our sample are as follows: 4 analyst opinion changes, 5 announcements about dividends or share repurchases, 11 earnings releases, 6 disclosures about an FDA / patent approval or the lifting of FTC restrictions, 9 announcements or updates to pending litigation (all unrelated to the indiscretion), 17 announced takeovers, 4 new product announcements, 1 announced proxy contest, 1 S&P index addition, and 5 instances of unscheduled management guidance.

[25] Test results excluding the confounding events are reported in Internet Appendix C and D. Not surprisingly, the univariate results are marginally stronger with the confounding events removed.

[26] We obtain similar results when examining long-run buy-and-hold stock returns (not reported, available upon request) and the change in Tobin's Q following the announcement (Internet Appendix E).

discipline following managerial misconduct [Karpoff and Lott (1993); Karpoff, Lee, Martin (2008); Murphy, Shrieves, and Tibbs (2009)]. This evidence lends support to the integrated affairs hypothesis.

4.2 Counterparty Response to Managerial Indiscretions

The integrated affairs hypothesis predicts a decline in counterparty trust and a deterioration in counterparty relationships, as other firms are less willing to conduct business with an indiscretion firm. To test this hypothesis, we examine whether the firm initiates or maintains new strategic alliances with major customers or joint venture partners. We collect data on meaningful counterparty relationships using two sources: the COMPUSTAT customer segment database and the SDC Joint Ventures database. If a firm is not listed in either of these two sources, we assume it does not have such relationships. Under SFAS 14 and 131, public companies must disclose the identity of any single customer representing 10% or more of total sales. We track whether the indiscretion firm obtains a new major customer representing at least 10% of sales in the year following the indiscretion and the change in the number of major customers in the years surrounding the indiscretion announcement. As a second measure, we also pull the entirety of the SDC Joint Ventures database and match it to our sample. We note the existence of a new JV partner and the change in the number JV partnerships surrounding the indiscretion announcement.

Table 7 reports tests on the impact that indiscretions have on counterparty trust. The results suggest that CEO indiscretions significantly decrease the likelihood of obtaining new major customers (model 1) and negatively impact the change in the number of major customers (model 3). The marginal effects imply that a CEO indiscretion is associated with a 2.1% lower likelihood of obtaining an additional major customer in the fiscal year following the indiscretion announcement, and a loss of 0.29 major customers from year (t-1) to year (t+1).[27] CEO indiscretions are associated with a 5.1% lower likelihood of initiating a new joint venture (model 4) and a loss of 0.22 venture partners (model 6). Given that the ex-ante

[27] We acknowledge the possibility that the firm may not lose the customer, but rather the customer's sales simply fall below the 10% threshold for mandatory reporting. Provided the measurement error induced by this reporting choice is uncorrelated with our explanatory variables, OLS is unbiased but the estimates will suffer from larger standard errors [Wooldridge (2002, p. 71-72)].

probabilities for obtaining a new customer or JV partner are 11.6% and 10.6%, respectively, these economic effects are meaningful.

The sample of major customers includes only business counterparties. Some venture partnerships, however, are with governmental entities who may be less concerned about reputation given their enhanced control rights inherent in the legal system. Consequently, we bifurcate venture partnerships into private industry partnerships and those with governmental entities (models 7 and 8). The results for joint ventures are concentrated among business counterparties. CEO indiscretions are insignificantly related to the change in the total number of government venture partners (model 8). These findings indicate that counterparty relationships in general, and industry relationships in particular, suffer in the presence of a managerial indiscretion, lending further evidence to the integrated affairs hypothesis.

Consistent with the results for direct disruption costs on *CARs* around the announcement of all indiscretions reported in Table 6, model (2) of Table 7 suggests that CEO reputational costs are significantly negatively related to the likelihood of obtaining a new major customer. Parameter estimates on CEO reputational costs imply that a one standard deviation increase in the reputational costs of a CEO indiscretion decreases the likelihood of obtaining a major customer by 3.81%.[28] Again, comparing the likelihood of obtaining a new customer of 11%, the economic effect is meaningful. Model (5) of Table 7 suggests that they are insignificantly related to the likelihood of initiating a new joint venture. CEO disruption costs, however, are insignificant in both models. The insignificance of the estimate suggests that, similar to penalties from environmental violations, direct disruption costs from getting caught have little effect on measurable counterparty relationships.

4.3 Managerial Indiscretions and Firm Operating Performance

The integrated affairs hypothesis predicts a loss of strategic relationships, which might force the firm into lower margin businesses where reputation is less important [Shapiro (1983)]. To quantify the

[28] The marginal effect is -0.2104 and a one standard deviation move is 0.4424, resulting in a decrease of -0.03805.

impact of an indiscretion on operating performance, we first define operating return on assets (OROA) as EBITDA to average total assets. To compute *Abnormal OROA*, we follow Barber and Lyon's (1996) matching firm methods and measure abnormal operating performance as the difference between the observed operating performance of the identified firm and that of the pre-event performance-adjusted industry benchmark. This adjustment removes biases in OROA resulting from industry norms or historical firm performance. In our primary operating performance tests, we further compute the change in this measure (*Abnormal* Δ *OROA*) to eliminate any time-invariant unobservable firm-specific biases in performance. We compute the change in the return on sales (*Abnormal* Δ *Profit Margin*) in a similar fashion.

Results of these tests are shown in Table 8. The firms in our indiscretion sample exhibit significantly lower operating performance than their industry- and performance-matched peers in the year of the indiscretion. Model 1 reports that, on average, sample firms demonstrate a marginally significant abnormal change in OROA of -0.8% over the fiscal year when an indiscretion is disclosed. These results are primarily driven by the indiscretions of CEOs (model 2), the individuals with the most impact on firm performance. When a CEO indiscretion is disclosed, the indiscretion group experiences an industry/performance-adjusted decline of 1.7% in operating performance, which is both statistically and economically significant. In contrast to our results on economic value for CEOs, untabulated analysis reveals no evidence of significant abnormal operating underperformance for the 'non-CEO' subgroup. This is not surprising given the relatively smaller influence these other executives often have on the formation of strategic partnerships or customer relationships.

To better understand the effect of managerial indiscretions on ROA and product market discipline, we also examine the change in profit margin. Model (4) of Table 8 indicates that on average the full sample of indiscretion firms demonstrates a negative but insignificant abnormal change in profit margin when an indiscretion is disclosed. However, in the fiscal year when a CEO indiscretion is disclosed (model 5), the firm experiences an industry/performance-adjusted decline of 5% in operating profit margin, which is both

statistically and economically significant. For both profit margin and OROA, the reputation costs play the dominant role in explaining the performance declines.

5. Managerial Indiscretions and Other Firm Consequences

Someone who is duplicitous in his or her private life could be more willing to mislead professionally. If indiscretions are signals of poor character in an executive's personal affairs, they could also indicate a willingness to falsify the financials. Evidence suggesting a correlation between personal misconduct and firm-level malfeasance would indicate a broader culture of misconduct at the firm. Thus, fraudulent activity might demonstrate that a manager and the firm are willing to abrogate contracts with their counterparties [Karpoff, Lee, and Martin (2008)]. Alternatively, the misconduct could be concentrated with the manager and not indicative of firm behavior and culture. In addition, the evidence in the previous section indicates underperformance during the period of the alleged indiscretion. Executives of an underperforming firm face additional pressure from the financial press, shareholders, and their boards. Evidence of explicit earnings management or legal action against the firm would be supportive of the integrated affairs hypothesis. In the sections that follow, we test the propensity for firms led by executives associated with indiscretions to be involved in corporate class action lawsuits, a DOJ or SEC enforcement action, and earnings management. In each case, we add dummy variables for CEO and non-CEO indiscretions along with estimates of direct and reputational costs to models established in the literature.

5.1 Managerial Indiscretions, Shareholder Class Action Lawsuits, and Fraud

The typical securities class action lawsuit alleges that managers violate Rule 10b-5 of the Securities Exchange Act of 1934 by fraudulently withholding negative information or publicizing false or misleading information [Niehaus and Roth (1999)]. In Panel A of Table 9, we estimate the propensity of a class period violation (when the wrongdoing allegedly is taking place) as defined by a shareholder class action lawsuit in the year of the indiscretion announcement or during the two years following. We control for known predictors of lawsuits [Gande and Lewis (2009); Field, Lowry, and Shu (2005); Fich and Shivdasani

(2007)]. The sample of securities class action lawsuits from 1996 through 2012 is collected from the Stanford Law School Securities Class Action Clearinghouse (SCAC) website. Shareholder lawsuits can be an expected response when a personal managerial indiscretion is alleged. Consequently, we delete any class action suits that target the indiscretion.

The results in models (1), (2), and (3) of Table 9 reveal that firms with executives committing managerial indiscretions are more likely to commit a violation that is targeted in shareholder class action suits. The marginal effects imply that an indiscretion increases the unconditional probability of wrongdoing by 5.5%.[29] As shown in model (2), the effect is more powerful for the CEO (marginal effect = 12.8%, p-value = 0.04). In model (3), where the CEO and non-CEO indicators are entered jointly, the coefficient is significant for CEO indiscretions (p-value = 0.04), but not for non-CEO indiscretions (p-value = 0.51). This suggests that, for class action lawsuits, we cannot rule out the interpretation that the CEOs are isolated bad apples. Although this could indicate the indiscretions are a signal about the top manager rather than the culture at large, we also cannot rule out the impact that CEOs have on the broader culture at the firm. In model (4), only the reputational costs predict bad behavior.

We similarly focus on the violation periods for corporate fraud. Relative to class action lawsuits, one would imagine a higher threshold for the filing of a federal fraud investigation against the company. Thus, the violations predicted here are likely more severe forms of malfeasance than the lawsuits. In models (1) through (4) of Table 9, Panel B, we estimate the propensity of fraud violations ultimately targeted by a DOJ or SEC enforcement action over the three-year period beginning with the indiscretion disclosure. We utilize two sources to identify the violation periods for corporate fraud. First, we use the fraud database assembled and maintained by Karpoff, Lee, and Martin (2008).[30] Second, we identify any instances of corporate fraud in the restatements file from Audit Analytics. As with shareholder class action lawsuits,

[29] Given a marginal effect at sample means of 0.374% and an unconditional probability of lawsuit at 6.821%, the implied economic effect is 0.00374 / 0.06821 = 0.0548 or 5.5%.

[30] We are grateful to the authors for providing us with the data.

prior research finds that the probability of fraud has observable predictors which we are careful to include in our models [Brazel, Jones, and Zimbelman (2009); Fich and Shivdasani (2007)].

Consistent with the results on shareholder initiated class action lawsuits, models (1), (2), and (3) in Table 9, Panel B indicate that firms with executives committing indiscretions are more likely to be investigated for fraud at the federal level. As before, results are greater in magnitude and significance for CEOs, but are now significant for both CEOs and non-CEOs. Also consistent with the findings for class action lawsuits in model 4, reputational costs are significant and positively related to fraud violations while the indiscretion's direct disruption costs are unrelated to fraud violations. As we have noted in other contexts, being targeted in a lawsuit does not indicate guilt any more than being accused of an indiscretion. However, this section does provide additional evidence on the linkage between alleged personal misconduct and alleged spillover effects at the firm as predicted by the integrated affairs hypothesis.

5.2 Managerial Indiscretions and Earnings Management

Healy and Wahlen (1999, p. 368) define earnings management as what "occurs when managers use judgment in financial reporting and in structuring transactions to alter financial reports *to either mislead some stakeholders about the underlying economic performance of the company*, or to *influence contractual outcomes* that depend on reported accounting numbers" (emphasis added). Since a firm's financials are often the only indications available to outside investors or other counterparties regarding the health of the company, 'managed' earnings have the potential to substantially influence perception of the firm. In this section, we examine the link between earnings management and managerial indiscretions.

To detect the presence of earnings management, we follow Dechow, Sloan, and Sweeney (1995) and focus on the manipulation of discretionary accruals. In models (1) through (3), we compute discretionary current accruals, as defined by Teoh, Welch, and Wong (1998), for our panel dataset of 15,950 firm-year observations and run cross-sectional ordinary least squares regressions to detect earnings management using our indiscretion indicator variables and a vector of controls guided by the literature.

Some researchers argue that just meeting or beating analyst earnings forecasts suggests more pervasive earnings management. Consequently, we also follow Koh, Matsumoto, and Rajgopal (2008) and identify firms where the discretionary accruals permitted the firm to meet or beat the annual analyst expectations for the fiscal year as reported in the Thomson Reuters I/B/E/S database. The (0,1) indicator, manage to meet, is the dependent variable in model (4). Finally, variations in operating performance among firms can lead to misspecification in estimating non-discretionary accruals. We further acknowledge the possibility that total accruals could present a better measure of earnings management and repeat the tests in models (5) and (6) using performance adjusted total accruals as in Kothari, Leone, and Wasley (2005).

The results presented in Table 10 suggest pervasive earnings management at firms where a member of the top management team commits a personal indiscretion. In the first model, the coefficient on the indiscretion indicator variable is positive and significant, noting the presence of significant earnings management during the fiscal year in which a managerial indiscretion is disclosed. The point estimate on the indiscretion indicator implies that the magnitude of discretionary accruals is higher by as much as 2.7% of total assets relative to those at the typical company. Focusing on the identity of the executive committing the indiscretion reveals that the result is driven by the CEOs in our sample. Firms reporting a CEO indiscretion are associated with abnormal accruals amounting to 5.8% of assets in the fiscal year. For comparison, Teoh et al. (1998) find abnormal accruals of around 5-6% for firms conducting an IPO. In unreported tests, we do not find significant abnormal accruals at firms where either a subordinate or a member of the board commits the indiscretion. Abnormal accruals are significantly increasing with the reputational costs of an indiscretion. Interestingly, disruption costs are negatively related to earnings management. While it could be that the disruption created by an indiscretion disclosure inhibits the ability of a duplicitous manager to manage earnings (i.e., the spotlight of concurrent litigation discourages pushing the fiscal envelope), this result is not predicted by our hypotheses. We do find that CEO indiscretions are

significantly positively related to the likelihood of managing to meet or beat analyst earnings forecasts. Similar results are obtained using performance adjusted total accruals in models (5) and (6).[31]

6. Labor Market Reaction to Managerial Indiscretions

In this section we ask whether managerial labor markets discipline indiscretion executives. We explore three forms of discipline for the executives involved in the indiscretions as well as for the board of directors at firms where the personal indiscretions occurred: CEO turnover, reductions in CEO pay, and lower votes for directors in shareholder elections.

6.1 Managerial Indiscretions and CEO Discipline

Examining CEO turnover in our setting is particularly beneficial for understanding the labor market penalties for misconduct. With other forms of corporate misconduct, such as financial misreporting, the insiders (and perhaps the board) are frequently aware of the behavior before it is publicly announced and turnover often occurs prior to the information being released to the market. As a result, researchers studying whether managers suffer personal consequences for malfeasance are limited in the power of their tests since dismissals prior to fraud disclosure impair identification. In our setting, both insiders and investors (and the researcher) learn of the misconduct at about the same time, so the test is better specified.

The models in Table 11 explore the relation between managerial indiscretions and CEO discipline by estimating logistic regressions on forced CEO turnover using the combined sample of 15,950 indiscretion and control firm-year observations. Our model includes other relevant predictors of turnover documented in the literature. We classify a turnover as forced using the procedure advocated by Parrino (1997).[32] Out of the 1,848 turnover events in the panel (11.6% of our sample firm-years), we classify 639 as forced (4.0% of the sample). Since the Parrino (1997) definition classifies any CEO departure over the

[31] The results presented in Table 5 and 6 imply that reputational costs and the overall losses in firm value are larger for indiscretions involving dishonesty. In Internet Appendix H, we report tests comparing dishonesty verses non-dishonesty indiscretions, which suggest that the results for lawsuits, fraud, and earnings management are positively related to cases of CEO dishonesty.

[32] Specifically, following Parrino (1997), we consider a change in the annual CEO as voluntary if the departing CEO is over the age of 60, leaves for reasons "Retired" or "Deceased," leaves to become the CEO of another firm, or is considered an interim CEO. All other turnovers are classified as forced.

age of 60 as voluntary, we are careful to include an indicator for whether the CEO is 61 or older.[33] We arrive at similar conclusions if we conduct our analysis on all CEO turnovers, regardless of age, rather than just forced or if we run our regressions on only those CEOs who are 59 years-old or younger.

Hazarika, Karpoff, and Nahata (2012) show that boards are more likely to dismiss CEOs for unethical job-related behavior. Consistent with this, we find that the disclosure of a personal indiscretion is hazardous to the career concerns of the CEO. The incidence of turnover for the entire sample is 36% of all indiscretion executives (regardless of title). An alleged CEO indiscretion significantly and substantially increases the conditional likelihood of forced turnover by 41.3% (from 4.0% to 45.3%). In untabulated results, Non-CEO indiscretions do not significantly increase the likelihood of forced CEO turnover. Those CEOs who are fired experience difficulty landing a similar position. As far as we can ascertain, only 24% of the dismissed indiscretion executives in our sample obtain another position as CEO. On average, it takes them 553 days to find their new post and this position pays, on average, $1.2 million less than their previous position.

Of particular interest among control variables is the role of governance. Recall that our poor monitoring index is a zero to four summation of dummy variables associated with poor governance (non-independence, hand-picked, large, and busy boards). The results of Table 11 indicate that the monitoring index by itself is insignificant, but that forced turnover increases with poor stock performance. Marginal effects imply that a one standard deviation decrease in stock price leads to a 6.9% increase in turnover. However, that effect is attenuated under lax board oversight. The marginal effect on the interaction of stock returns with the poor monitoring index is a significantly positive 0.6%, suggesting that incrementing the index by one unit decreases the performance-turnover sensitivity documented above by about 9% (=0.6/6.9). Thus, disciplinary turnover is significantly less likely for poorly performing and poorly monitored CEOs.

[33] We thank an anonymous referee for this suggestion.

If a firm's integrity is weakened due to a CEO's indiscretion, the firm could fire the CEO to signal that it takes the lack of integrity of its corporate leader as a serious matter. Thus, one implication of the integrated affairs hypothesis is that CEO dismissal should be more pronounced for indiscretions involving higher reputational costs. The results from model (2) provide some evidence in support of this hypothesis as CEO reputational costs are significantly and positively associated with CEO turnover. This result is striking and suggests that the integrated affairs hypothesis drives board and shareholder behavior. The fact that CEO turnover is more likely following indiscretion-related declines in stock price supports the view that investors care about managerial indiscretions when they affect firm value and will discipline the manager accordingly.

The question remains regarding what happens to those executives who are able to retain their jobs. Do they face some sort of discipline short of being fired? To shed light on this, we examine the change in the CEO's salary and bonus while restricting the sample to the 12,444 firm-year observations where there is no turnover in the year prior and the year of the managerial indiscretion. Model (3) of Table 11 reveals a significant and substantial reduction in CEO pay in the year following the announcement of the indiscretion. Our estimates suggest that CEO pay falls by $388k, indicating that boards assess a financial penalty for personal missteps. The change in CEO pay is also decreasing in CEO reputational costs and CEO disruption costs, indicating that when the costs of an indiscretion are greater for the firm, it enforces greater discipline on the individual charged with the indiscretion.

6.2 Managerial Indiscretions and Director Elections

A related and interesting question is whether board members overseeing 'low integrity executives' face repercussions from shareholders when they go up for election at the annual meeting. Few board members would suggest that they should be held responsible for monitoring the private extracurricular activities of their executives. To determine if shareholders reflect discontent with directors of indiscretion firms, we examine the shareholder vote totals of these boards. Table 12 presents firm- and calendar year-

fixed effects regressions of the voting results for 86,836 director elections from 2,108 unique firms in the ISS Shareholder Voting database from 2003 to 2013. The dependent variable is the Percent "For" Votes observed for each director, where the percentage "For" is defined as the votes "For" divided by the sum of the votes "For" and "Against." The key independent variable of interest, indiscretion, is an indicator which takes on the value of '1' if a managerial indiscretion is disclosed during the prior fiscal year and '0' otherwise. *CEO Indiscretion* indicates an indiscretion by the firm's CEO while, *Board Member Indiscretion* indicates the offending executive was a member of the board of directors. *Board Leadership Indiscretion* indicates whether the offending executive is a member of the standing nominating, compensation, audit, or governance committees. Control variables include firm size, performance, standard governance measures, indications of litigation and accounting restatements, and other variables following Cai, Garner, and Walkling (2009).

Results for all four main variables of interest indicate significantly lower votes for directors following the announcement of a personal indiscretion by an executive of their firm. Vote totals are significantly lower if an indiscretion occurred, if the CEO was involved in the indiscretion, if a board member was involved in the indiscretion, and if the executive associated with the indiscretion was a member of the nominating, compensation, audit, or governance committees.[34] The magnitude of the 1% to 2% lower vote total is comparable to the shareholder reaction to the firm being targeted by material litigation or underperforming its industry ROA benchmark by about 1%. Similar to Cai, Garner and Walkling (2009), the change in vote totals we observe is unlikely to deny any board member a seat. However, those authors also show that even small changes in votes are associated with significant changes in board behavior, including adjustments in executive pay and the removal of takeover defenses. Model (2) suggests that the impact on the "for" votes is significantly influenced by the reputational costs as opposed to the disruption costs of an indiscretion. This suggests that, consistent with the integrated affairs hypothesis, shareholders

[34] Tests comparing the impact of dishonesty versus non-dishonesty indiscretions indicate that voting outcomes are largely driven by indiscretions involving acts of dishonesty. These are reported Internet Appendix.I.

consider the board at least partially responsible for integrity concerns of those whom they monitor. The results here are particularly interesting since they apply to all board members at the firm and not just the offending executive. We find this governance association intriguing, as few would suggest that the role of board oversight extends into the CEO's bedroom or extra-curricular activities. These results are consistent with shareholder rejection of the separate affairs hypothesis in their voting patterns for the executives involved and for the directors associated with these executives.

7. Summary and Conclusions

By the time a company's ethical problems are apparent in the boardroom, they have resulted in a dramatic loss of shareholder value. Many executives, however, are accused of indiscretions in their personal lives, including allegations of *sexual misadventure, substance abuse, violence*, and *dishonesty*. A priori, these incidents have no direct link to the business operations or financial decisions of the firm and, under the *separate affairs* hypothesis, they should have no impact on firm value. Indeed, a leading auditing standard states that in auditing for non-compliance, auditors should ignore personal executive indiscretions. In contrast, the *integrated affairs* hypothesis suggests that these personal incidents *will* hurt shareholders. This hypothesis states that the personal indiscretion signals traits that influence financial reporting, corporate behavior, and the trust of shareholders and other stakeholders.

We test these hypotheses in several ways. First, we examine wealth effects associated with announcements of the indiscretions. On average, there is an immediate 4.1% loss in shareholder value at the disclosure of a CEO indiscretion and operating performance suffers an abnormal decline in the same fiscal year. A decline in firm value, however, could simply indicate that it was not optimal for the executive to be caught; it does not necessarily indicate losses due to signals of low integrity. Consequently, we decompose the total cost into its reputational and direct components and examine associated impacts on counterparty business. We find significant reductions in counterparty relationships associated with indiscretions in general and reputational costs in particular. CEO indiscretions are associated with

significant declines in the number of new major customers and joint venture partnerships. Customer losses are particularly severe for those indiscretions that damage the firm's reputation the most.

The market could anticipate that some industries are more inclined to hire managers with low integrity. If questionable behavior is anticipated, the announcement of an indiscretion will have less of a negative impact. Indeed, firms in industries with above median amounts of enforcement actions and non-compliance reports are associated with smaller market reactions to announced indiscretions.

Additional evidence suggests that these observable signals of poor managerial character provide investors a 'canary in the coal mine' with regard to future malfeasance. In particular, we find that those firms whose executives commit a managerial indiscretion are significantly more likely to manage reported earnings and their firms are also more likely to engage in wrongdoing targeted by shareholder class action lawsuits and DOJ/SEC fraud investigations.

Finally, the managerial labor markets do not stand idle in light of these disclosures. CEO turnover increases dramatically in the wake of an indiscretion and compensation declines for CEOs who are retained. The collateral damage goes further: at least some shareholders seem to hold board members responsible for indiscretions associated with the firm's executives. Board members receive significantly lower votes in the director election immediately following announcement of an indiscretion. Collectively, our results imply that the personal integrity of the top management team plays an important role in the valuation and business operations of the firm.

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Table 1
Examples of Alleged Managerial Indiscretions

Executive	Company	Title	Notes	Media Citation
Sexual Misadventure				
Mark V. Hurd	Hewlett Packard Co.	Chairman, CEO, and President	Dismissed for allegedly harassing HP contract employee and violations of the company's standards of business conduct. Hurd admits to not living up to "standards and principles of trust" upon termination.	HP CEO Mark Hurd Resigns Amid Sexual Harassment Probe, *Forbes.com* (8/6/2010)
Mossimo Giannulli	Mossimo Inc.	Chairman of the Board	Accused of creating a "severe, pervasive, sexually hostile work environment" and of wrongful termination in retaliation for complaints.	Former Worker Accuses Mossimo Fashion Executives of Sexual Harassment, *Knight Ridder Tribune Business News* (1/25/2000)
David C. Colby	Wellpoint Inc.	EVP, CFO, and Vice Chairman	Accused of orchestrating numerous, simultaneous affairs (at least one with a Wellpoint employee). An internal probe deemed the actions a violation of the company's code of conduct.	WellPoint Finds Itself Embroiled In Private Drama --- Ex-Finance Chief's Web Of Multiple Romances Entangles Health Giant, *The Wall Street Journal* (6/12/2007)
Substance Abuse				
William D. Parker	U.S. Airways Group Inc.	Chairman & CEO	Arrested for DUI while leaving the FBR Open golf tournament just hours after failed merger bid for Delta.	US Airways CEO admits 2 prior DUI convictions: Parker says he was in his 20s at time, makes apology, *McClatchy-Tribune Business News* (2/10/2007)
Peter H. Coors	Molson Coors Brewing Co.	Chairman	Cited for DUI and failure to observe a traffic-control device.	Pete Coors Is Issued A Charge of DUI, *The Wall Street Journal (*7/14/2006)
Dale M. Gibbons	Zions Bancorporation	EVP & CFO	Arrested for charges of drug possession and child abuse. Salt Lake Sheriff's investigations revealed significant quantities of methamphetamine at his home and his 15-year-old daughter intoxicated and comatose.	CFO of parent company arrested, *Las Vegas Sun* (6/22/2001)
Violence				
Herbert H. Haft	Dart Group Corp.	Chairman & CEO	Wife alleges domestic violence and numerous affairs in divorce filing.	Hafts Take Fight to Divorce Court; Wife Alleges Physical, Verbal, Financial Abuse in Separation Filing, *The Washington Post* (08/11/1993)
Charles E. Johnson	Franklin Resources Inc.	President	Charged with misdemeanor domestic violence battery, felony false imprisonment and misdemeanor child endangerment. Allegedly beat his wife in front of his children.	Franklin Resources exec charged with beating wife in Hillsborough, *Associated Press Newswires* (10/2/2002)
Patrick J. Naughton	Infoseek Corp.	Executive VP-Products	Attempted to solicit an undercover FBI agent posing as a 13-year-old girl. Infoseek was Disney's partner in the Go.com internet portal at the time.	Infoseek Executive, Due for Disney Post, Charged With Luring Minor on Internet, *The Wall Street Journal* (9/20/1999)
Dishonesty				
Scott Thompson	Yahoo! Inc.	CEO, President, and Director	Falsely claimed to possess a computer science degree from Stonehill College. Does hold accounting degree.	Yahoo Cites 'Inadvertent Error' in CEO Academic Record, *The Wall Street Journal* (5/4/2012)
James J. Minder	Smith & Wesson Holding Corp.	Chairman of Board	Failed to disclose 15 year term in prison for armed robbery.	Smith & Wesson chief quits over crime, *CNNMoney.com* (2/27/2004)
Kenneth E. Lonchar	Veritas Software Corp.	Executive VP & Chief Finance Officer	Claimed unearned MBA degree from Stanford University.	Veritas Says Books Are Clean, Even If CFO's Past Muddled, *Dow Jones News Service* (10/3/2002)

Table 2
Sample Constitution and Indiscretion Executive Characteristics

This table presents the composition of our 325 sample observations from 1978 to 2012. Panel A indicates the number of observations by executive identity and their role at the sample firms. The *Number of Executives* indicates unique executives and *Number of Indiscretions and Primary Firm Obs.* indicates the number of unique events. Some sample executives hold multiple offices at different firms. We identify their *Primary Firm* as the place of primary employment, while the *Secondary Firm* as the office of any ancillary appointment. Panel B itemizes the sample observations by indiscretion type. *Sexual Misadventure* refers to non-criminal illicit sexual activity, *Substance Abuse* represents cases of drug or alcohol abuse, *Violence* reflects cases of battery or criminal sexual violence, and *Dishonesty* represents cases of public dishonesty, such as plagiarism or résumé fraud. More thorough descriptions of each indiscretion are provided in the text. Panel C documents the method of disclosure. *Company Press Release* indicates a company revealed indiscretion. *Legal Filing* indicates that the disclosure was publicized by major legal filing. *Media Report* notes cases where the media discovers indiscretion. Panel D details the title held by the executive. *Directors* indicates the executive's only role at the firm is that of chairman of the board or a corporate director. For corporate officers, these titles are further disaggregated by whether the executive is either the company's *CEO* or a *Subordinate Executive* where he holds some other title at the company (President, CFO, COO, Division Head, etc.). *Founding Family Executive* indicates the indiscretion executive is a member of the founding family. Panel E describes the type of executives involved in the 219 sample primary firm indiscretions as well as the outcome of each event for the executive. Proportions are provided for the subset of observations with complete data. *Age* and *Male* indicate the age and gender of the offending executive. *Repeat Offender* indicates that the executive has been accused of another indiscretion at some point in the past. *Executive Turnover* indicates whether the executive leaves the firm within 30 days of the first disclosure of the indiscretion. Panel F reports the direct costs resulting from the managerial indiscretions. *Corporate Lawsuit* and *Material Legal Expenses* indicate the proportion of the 325 observations which involve a lawsuit or an associated legal expense (legal defense fees, settlement, etc). *Corporate Settlement* indicates that there is some form of corporate settlement even if it is not material enough to be disclosed. *Legal Fees or Settlement Disclosed* is the proportion of observations where the firm discloses the legal expenses relating to the indiscretion. *Legal Expense Amount* is the dollar amount of settlements or legal fees for those cases where it is disclosed. *Opportunity Costs* can be measured in 65 cases and include time away from work for company *Training or Rehab* for substance abuse, lost hours due to a *Suspension* or other time *Out of Work*, time spent in *Jail or Court* defending or serving time for the indiscretion. *Opportunity Cost (in Days)* and *Opportunity Cost (Amount)* reflect the number of days and value lost due to the indiscretion. In 32 cases there is a *Severance* package paid to the executive at turnover and this is reported in *Severance Amount*. *Fired for Cause* indicates the cases where the executive is officially fired "for cause" as opposed to just tendering their resignation. *Forfeiture of Pay* indicates the executive lost pay either by claw backs, forfeiture of unvested stock and options, or loss of bonuses and *Forfeiture of Pay Amount* details the dollar amount lost. The *Disruption Costs* add up the dollar value of the litigation expenses, opportunity costs, severance packages, and any other direct costs associated with the indiscretion, while *Disruption Costs to Sales* normalizes this figure by firm net revenues. *Reputational Costs* equal the abnormal market value loss at the announcement, as determined by the (-1,+1) cumulative abnormal return (CAR) times the pre-event market value of equity, minus the total disruption costs. *Reputational Costs to Sales* normalizes this figure by firm net revenues. All reported values are winsorized at the 1st and 99th percentile.

Panel A: Frequency of Sample Observations

Category	Number of Executives	Number of Indiscretions and Primary Firm Obs.	Secondary Firm Obs.	Total Observations
In-Sample Single Offenders with One Role	124	124	0	124
In-Sample Single Offenders with Multiple Roles	54	54	87	141
In-Sample Repeat Offenders with One Role	10	24	0	24
In-Sample Repeat Offenders with Multiple Roles	7	17	19	36
Total	**195**	**219**	**106**	**325**

Panel B: Frequency by Indiscretion Type

Type of Indiscretion	Number of Executives	%	Primary and Secondary Obs.	%
Sexual Misadventure	92	47.2%	153	47.1%
Substance Abuse	17	8.7%	35	10.8%
Violence	13	6.7%	29	8.9%
Dishonesty	73	37.4%	108	33.2%
Total	**195**	**100.0%**	**325**	**100.0%**

Panel C: Initial Source of Disclosure

Type of Indiscretion	Number of Executives	%	Primary and Secondary Obs.	%
Company Press Release	49	25.1%	72	22.2%
Legal Filing	73	37.4%	121	37.2%
Media Report	73	37.4%	132	40.6%
Total	**195**	**100.0%**	**325**	**100.0%**

Panel D: Title Held by Executive

Executive Role	Number of Executives	%	Primary and Secondary Obs.	%
Founding Family Executive	45	23.1%	62	19.1%
Directors	21	10.8%	119	36.6%
CEOs	90	46.2%	113	34.8%
Subordinate Executives	84	43.1%	93	28.6%
Total	**195**	**100%**	**325**	**100%**

Panel E: Personal Characteristics for Primary Firm Observations (n=219)

	Sexual Misadventure	Substance Abuse	Violence	Dishonesty	Full Sample
Age and Gender					
Age	51.7	52	50.1	53.3	52.16
Male	97.10%	95.00%	100.00%	95.10%	96.30%
Executive Details					
Repeat Offender	33.01%	55.00%	33.33%	16.05%	28.77%
Executive Turnover	33.98%	20.00%	53.33%	38.27%	35.62%

Panel F: Direct Costs Resulting From Managerial Indiscretions

Litigation Expenses	Corporate Lawsuit	Material Legal Expenses	Corporate Settlement	Legal Fees or Settlement Disclosed	Legal Expense Amount
N	325	325	325	325	34
Mean	22.77%	15.38%	14.77%	10.46%	$2,247,610

Opportunity Costs	Opportunity Cost	Training or Rehab	Suspension or Out of Work	Jail or Court	Opportunity Cost (in Days)	Opportunity Cost (Amount)
N	325	65	65	65	65	65
Mean	20.00%	18.46%	18.46%	80.00%	27.82	$27,465

Severance and Mitigating Compensation Costs	Severance	Severance Amount	Fired for Cause	Forfeiture of Pay	Forfeiture of Pay Amount
N	325	32	325	325	16
Mean	9.85%	$3,613,113	6.77%	4.92%	$8,072,126

Total Direct Disruptive and Reputation Costs	Disruption Costs	Disruption Costs to Sales	Reputational Costs	Reputational Costs to Sales
N	325	325	325	325
Mean	$616,399	0.19%	$109,295,830	6.28%

Table 3
Sample Statistics

This table presents sample summary statistics for 325 managerial indiscretion observations from 1978 to 2012 and 15,950 firm-year observations from the EXECUCOMP/RiskMetrics (IRRC) universe from 1996 to 2012. *Sales* and *Market Value* are the net revenues and market value of common equity, respectively, in millions. *Leverage* is total liabilities divided by total assets. *CAPX* is capital expenditures to sales. *Diversification* is the number of business segments. *Firm Age* is the number of years the firm is listed on CRSP or COMPUSTAT. *OROA* is earnings before interest, taxes, depreciation, and amortization (EBITDA) to total assets. *Tobin's Q* is computed as the market value of equity plus the book value of assets less the book value of assets all over the book value of assets. *Stock Return* is the buy-and-hold raw stock return for the fiscal year in which the indiscretion occurs. *CEO Ownership* is the percentage of common stock held by the CEO. *CEO Age* and *CEO Tenure* are the age and job tenure of the primary CEO. *Family Managed Firm* is a (0,1) indicator of whether the company is a family held or founder managed firm (but does not indicate that the indiscretion executive is a member of this family). *CEO-Chairman* is an indicator of whether the CEO is also the chairman of the board. *Outside Director Ownership* is the aggregate percentage ownership of the common shares held by all of the independent directors on the board. *Board Size* is the number of directors on the board, while *Large Board* indicates that the board size is over the median of all firms. *Percent Independent Directors* is the percentage of the board which is comprised of outsiders as defined by RiskMetrics (IRRC). *Non-Independent Board* is in an indicator of whether 50% of the board is classified as non-independent. *Hand-Picked Board* is an indicator of whether 50% or more of the independent directors have a tenure shorter than that of the CEO. *Busy Board* is an indicator of whether 50% or more of the outside directors hold three or more total directorships. *Poor Monitoring Index* is a (0,4) index summing Large Board, Non-Independent Board, Hand-Picked Board, and Busy Board. All reported values are winsorized at the 1st and 99th percentile.

	Means		**Medians**	
	Managerial Indiscretions (N = 325)	**Panel Data Sample (N = 15,950)**	**Managerial Indiscretions (N = 325)**	**Panel Data Sample (N = 15,950)**
Firm Characteristics (t)				
Sales ($M)	21,442	5,890	2,231	1,719
Market Value ($M)	23,478	8,354	2,353	1,948
Leverage	0.64	0.53	0.61	0.54
CAPX	0.23	0.07	0.04	0.04
Diversification	3.03	3.13	3.00	3.00
Firm Age	26.14	31.67	18.00	26.00
Performance Characteristics (t)				
OROA	6.36%	13.82%	11.13%	13.29%
Tobin's Q	2.25	1.89	1.47	1.52
Stock Return	1.97%	12.31%	0.00%	8.86%
CEO Characteristics (t-1)				
CEO Ownership	6.66%	2.14%	0.34%	0.29%
CEO Age	54.56	55.83	54.00	56.00
CEO Tenure	7.49	7.88	5.00	5.82
Governance Characteristics (t-1)				
Family Managed Firm	0.59	0.34	1.00	0.00
CEO-Chairman	0.58	0.61	1.00	1.00
Outside Director Ownership	1.70	1.21	0.12	0.28
Board Size	10.26	9.30	10.00	9.00
Large Board	0.54	0.42	1.00	0.00
Percent Independent Directors	63.43%	69.82%	66.67%	72.73%
Non-Independent Board	0.19	0.11	0.00	0.00
Hand-Picked Board	0.61	0.53	1.00	1.00
Busy Board	0.33	0.19	0.00	0.00
Poor Monitoring Index	1.67	1.26	2.00	1.00

Table 4
Association Between Managerial Indiscretions and Observable Firm Characteristics

This table presents logistic regressions which model the association between managerial indiscretion announcements and observable firm characteristics. The dependent variable in models (1)-(4) is a (0,1) indicator variable signifying whether an *Indiscretion*, *CEO Indiscretion*, or a *Non-CEO Indiscretion* occurred in the fiscal year. The dependent variable in models (5) and (6) is a (0,1) indicator of whether an indiscretion is disclosed by an outside entity (e.g., law enforcement, media) rather than through a company press release. *Firm Size* is the natural log of net sales. *Ind-Adj ROA* is EBITDA to Assets minus the industry median value. *Ind-Adj Tobin's Q* is Tobin's Q minus the industry median value. *Shady Industry (Non-Compliance)* indicates the firm resides in an industry with a degree of regulatory non-compliance greater than the median for all industries [Kedia, Luo, and Rajgopal (2016)], while *Shady Industry (BPI)* denotes firms in sectors with grand bribery scores less than the median value of Transparency International's 2011 Bribe Payers Index (BPI) [Karpoff, Lee, and Martin (2015)]. All other variables are defined in Table 3. Each model includes industry and year fixed-effects and p-values are computed using robust Rogers (1993) firm-clustered standard errors.

	Indiscretion				**CEO Indiscretion**		**Non-CEO Indiscretion**		**Outside Disclosure Indiscretion**			
	(1)		(2)		(3)		(4)		(5)		(6)	
	Estimate	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**
Intercept	-6.53	0.00	-6.33	0.00	-5.97	0.00	-7.81	0.00	-7.67	0.00	-8.17	0.00
Poor Monitoring Index	0.38	0.00			0.54	0.00	0.30	0.00	0.43	0.00	0.50	0.00
Non-Ind. Board			-0.11	0.65								
Large Board			0.46	0.00								
Busy Board			0.42	0.01								
Hand-Picked Board			0.59	0.00								
Shady Industry (Non-Compliance)									-0.11	0.60		
Shady Industry (BPI)											0.13	0.54
Firm Size	0.31	0.00	0.29	0.00	0.15	0.24	0.38	0.00	0.41	0.00	0.37	0.00
Firm Age	-0.01	0.18	-0.01	0.20	-0.01	0.11	0.00	0.44	-0.01	0.19	-0.01	0.11
Family Managed Firm	0.94	0.00	0.98	0.00	1.22	0.00	0.82	0.00	1.06	0.00	1.14	0.00
Leverage	0.53	0.31	0.45	0.38	0.53	0.55	0.54	0.37	0.59	0.33	0.90	0.14
Capital Expenditures	-0.27	0.79	-0.21	0.83	-0.20	0.89	-0.35	0.78	0.55	0.62	0.04	0.97
Ind-Adj ROA	-1.73	0.15	-1.76	0.14	0.47	0.78	-3.00	0.05	-1.44	0.28	-1.03	0.44
Ind-Adj Tobin's Q	0.18	0.04	0.18	0.05	-0.02	0.90	0.30	0.01	0.13	0.21	0.12	0.25
CEO Age	-0.02	0.16	-0.02	0.17	-0.03	0.09	-0.01	0.69	-0.01	0.28	-0.01	0.41
CEO Ownership	0.08	0.00	0.09	0.00	0.10	0.00	0.07	0.00	0.09	0.00	0.09	0.00
CEO Tenure	-0.07	0.00	-0.08	0.00	-0.05	0.03	-0.09	0.00	-0.08	0.00	-0.09	0.00
Outside Director Ownership	0.00	0.92	0.00	0.90	0.04	0.31	-0.02	0.59	0.02	0.50	0.04	0.30
Likelihood Ratio	265.18	0.00	271.88	0.00	112.89	0.00	189.52	0.00	259.97	0.00	249.40	0.00
Pseudo R^2	0.0276		0.0289		0.0093		0.0196		0.0304		0.0314	
N	15,950		15,950		15,950		15,950		15,950		15,950	

Table 5
Managerial Indiscretions and Firm Value

This table presents the impact of 325 managerial indiscretions on firm value as indicated by the 3-day and 5-day cumulative abnormal returns (CAR) at disclosure using standard event study methods [Brown and Warner (1985)]. Investor reactions are presented for the full sample, split by the investor reactions at the executive's *primary firm* and *secondary firm*, by executive title, and by turnover. *CEO* indicates whether the executive committing the indiscretion is the firm's chief executive officer, while *Non-CEO* denotes some other executive or director at the firm. *Turnover at Announcement* indicates the executive leaves within 30 days of the announcement, while *Executive Retained* indicates that the executive remains at the firm. Announcement returns are further disaggregated by *Sexual Misadventure*, *Substance Abuse*, *Violence*, and *Dishonesty* which are described in Table 2 and the text. *Shady Industry (Non-Compliance)* indicates the firm resides in an industry with a degree of regulatory non-compliance greater than the median for all industries [Kedia, Luo, and Rajgopal (2016)], while *Shady Industry (BPI)* denotes firms in sectors with grand bribery scores less than the median value of Transparency International's 2011 Bribe Payers Index (BPI) [Karpoff, Lee, and Martin (2015)]. P-values using Student's t tests and non-parametric Wilcoxon signed-rank tests are reported in parentheses.

		(-1,+1) CAR		(-2,+2) CAR	
	N	**Mean**	**Median**	**Mean**	**Median**
Overall Announcement Returns					
Full Sample	325	-1.62%	-0.58%	-1.73%	-0.68%
		(0.00)	(0.00)	(0.00)	(0.00)
Announcement Returns by Primary v. Secondary Firm					
Primary Firm	219	-2.34%	-1.12%	-2.27%	-0.97%
		(0.00)	(0.00)	(0.00)	(0.00)
Secondary Firm	106	-0.13%	-0.34%	-0.61%	-0.40%
		(0.78)	(0.26)	(0.58)	(0.19)
Announcement Returns by Title					
CEO	113	-4.06%	-1.84%	-3.80%	-2.28%
		(0.00)	(0.00)	(0.00)	(0.00)
Non-CEO	212	-0.32%	-0.37%	-0.62%	-0.42%
		(0.48)	(0.30)	(0.23)	(0.14)
Announcement Returns by Turnover					
Turnover at Announcement	89	-2.32%	-0.89%	-1.97%	-0.55%
		(0.02)	(0.01)	(0.03)	(0.03)
Executive Retained	236	-1.35%	-0.54%	-1.63%	-0.77%
		(0.00)	(0.00)	(0.01)	(0.01)
Announcement Returns by Indiscretion Type					
Sexual Misadventure	153	-0.63%	-0.40%	-0.45%	-0.49%
		(0.05)	(0.11)	(0.27)	(0.28)
Substance Abuse	35	-0.69%	-0.37%	-0.49%	0.05%
		(0.25)	(0.54)	(0.94)	(0.87)
Violence	29	-1.67%	-1.95%	-2.62%	-2.71%
		(0.04)	(0.06)	(0.00)	(0.00)
Dishonesty	108	-2.84%	-1.19%	-2.49%	-0.89%
		(0.00)	(0.00)	(0.00)	(0.00)
Announcement Returns by Shady Industry					
Shady Industry (Non-Compliance)	161	-1.11%	-0.34%	-0.71%	0.00%
		(0.06)	(0.07)	(0.29)	(0.57)
Non-Shady Industry (Non-Compliance)	164	-2.12%	-1.05%	-2.73%	-1.40%
		(0.00)	(0.00)	(0.00)	(0.00)
Shady Industry (BPI)	146	-1.74%	-0.57%	-2.20%	-0.72%
		(0.03)	(0.03)	(0.02)	(0.03)
Non-Shady Industry (BPI)	179	-1.52%	-0.58%	-1.34%	-0.62%
		(0.00)	(0.00)	(0.01)	(0.01)

Table 6
Managerial Indiscretions and Firm Value Regressions

This table presents regressions of the (-1,+1) cumulative abnormal returns (*CAR*) at the indiscretion announcement for our sample of 325 managerial indiscretions [model (1)]. Models (2)-(5) are run on subsets stratified by the indiscretion category. *Sexual Misadventure*, *Violence*, and *Dishonesty* denote the category of indiscretion and are described in Table 2 and the text. Models (6) and (7) bifurcate this sample on the basis of whether the firm is in a *Shady Industry* or *Non-Shady Industry*, respectively, where shady industry is identified by non-compliance with federal regulations [Kedia, Luo, and Rajgopal (2016)] or by Transparency International's Bribe Payers Index [Karpoff, Lee, and Martin (2015)]. *Disruption Costs* are the direct disruption costs defined in Table 2 normalized by sales. *TO at Announcement* indicates the executive left the firm at the time of the announcement. *With Subordinate* indicates that the indiscretion involved another employee of the firm. *Founding Exec* indicates the executive is a member of the founding family. *Confounding Event* indicates that the firm announces some other event that is generally regarded as influencing stock returns (e.g., earnings guidance, mergers, new product announcements, etc.). *Firm Size* is the natural log of net sales. *Market-Adj Return* is the firm's net-of-market stock return for the 250 trading days preceding the indiscretion. All other variables are defined in Tables 2 and 3.

	(-1,+1) Cumulative Abnormal Return (*CAR*)																	
	(1)		**(2)**		**(3)**		**(4)**		**(5)**		**(6)**		**(7)**		**(8)**		**(9)**	
	Estimate	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**
Intercept	-0.013	0.61	-0.009	0.61	-0.094	0.11	-0.034	0.38	-0.035	0.38	0.007	0.85	-0.021	0.55	-0.085	0.26	-0.004	0.87
CEO	-0.036	0.00	-0.029	0.00	-0.012	0.48	-0.015	0.44	-0.077	0.00	-0.026	0.04	-0.046	0.00	-0.020	0.46	-0.036	0.00
Disruption Costs	0.002	0.76	-4.946	0.02	-0.016	0.69	8.787	0.16	0.368	0.62	-1.913	0.00	0.004	0.58	-8.930	0.00	0.001	0.90
Sexual Misadventure	-0.006	0.74									0.030	0.24	-0.034	0.18	-0.019	0.72	-0.003	0.87
Violence	-0.012	0.55									0.011	0.67	-0.030	0.30	-0.029	0.63	-0.006	0.76
Dishonesty	-0.039	0.03									0.004	0.86	-0.064	0.01	-0.056	0.30	-0.035	0.06
With Subordinate	0.000	1.00									0.003	0.87	-0.006	0.74	0.009	0.78	-0.001	0.91
TO at Announcement	-0.003	0.75	0.024	0.01	0.016	0.52	0.022	0.36	-0.037	0.11	-0.010	0.45	0.006	0.65	0.015	0.55	-0.009	0.37
Arrest	-0.019	0.16	0.003	0.89	0.012	0.48	-0.018	0.40	-0.054	0.10	0.014	0.43	-0.043	0.03	-0.082	0.02	-0.009	0.53
Repeat Offender	0.007	0.49	0.006	0.54	0.019	0.24	-0.022	0.37	0.052	0.16	0.005	0.71	0.004	0.77	0.029	0.26	0.003	0.79
Founding Exec	-0.002	0.87	0.007	0.59	0.025	0.26	0.002	0.95	-0.032	0.41	-0.019	0.27	0.024	0.16	-0.016	0.64	0.006	0.65
Confounding Event	0.023	0.03	0.034	0.00	0.021	0.25	0.059	0.01	-0.005	0.85	-0.004	0.78	0.046	0.00	0.007	0.79	0.021	0.07
Poor Mon. Index	-0.002	0.75	0.005	0.26	0.009	0.27	0.004	0.63	-0.006	0.69	-0.003	0.69	0.007	0.29	0.005	0.69	0.001	0.84
Firm Size	0.004	0.08	-0.001	0.78	0.006	0.19	0.000	0.94	0.007	0.21	-0.001	0.85	0.004	0.17	0.011	0.05	0.001	0.57
ROA	-0.025	0.04	-0.020	0.21	-0.088	0.56	0.105	0.01	-0.040	0.10	-0.024	0.18	-0.011	0.52	-0.058	0.00	-0.019	0.14
Tobin's Q	0.000	0.97	0.000	0.89	0.002	0.87	0.002	0.54	0.000	0.96	-0.003	0.04	0.003	0.01	0.003	0.21	0.002	0.13
Market-Adj Return	0.011	0.25	0.001	0.91	0.030	0.16	0.027	0.18	0.020	0.42	0.024	0.06	0.003	0.82	0.013	0.61	0.013	0.16
Sample	All Indiscretions		Sexual Misadventure		Substance Abuse		Violence		Dishonesty		Shady Industry (Non-Compliance)		Non-Shady Industry (Non-Compliance)		Shady Industry (BPI)		Non-Shady Industry (BPI)	
F-Statistic	3.60	0.00	3.59	0.00	1.30	0.28	2.97	0.02	2.22	0.02	4.07	0.00	3.36	0.00	4.27	0.00	2.50	0.00
R^2	0.1574		0.2353		0.4153		0.6900		0.2186		0.3115		0.2680		0.3461		0.1981	
N	325		153		35		29		108		161		164		146		179	

Table 7
Counterparty Response to Managerial Indiscretions

This table presents the likelihood of obtaining a new counterparty following an indiscretion disclosure during the fiscal year using the universe of firms listed in EXECUCOMP from 1996 to 2012. Models (1) and (2) are logistic regressions where the dependent variable is a (0,1) indicator of whether the firm *Obtains a New Major Customer* in the COMPUSTAT customer segment database. Model (3) is an OLS regression of the *Change in the Number of Major Customers* the firm has from fiscal t-1 to t+1. Models (4) and (5) are logistic regressions where the dependent variable is an indicator of whether the firm *Initiates a New Joint Venture* (JV) in the SDC Platinum Alliances database. Model (6) is an OLS regression of the *Change in the Number of Active Joint Ventures* the firm has from fiscal t-1 to t+1. The dependent variable in models (7) and (8) partition the change in the number of venture partners by whether the counterparties are industrial or governmental agencies. The key independent variable of interest, *CEO Indiscretion*, is a (0,1) indicator variable which takes on the value of '1' if a CEO indiscretion is disclosed during the fiscal year and '0' otherwise. *CEO Reputation Costs* and *CEO Disruption Costs* are the reputational and disruption costs normalized by sales described in Table 2 for CEO indiscretions, where the direct costs are rescaled by multiplying by 1,000. *Customer Base* and *Alliance Experience* are the number of major customers and active joint ventures maintained as of the start of the fiscal year. *Technical Intensity* is R&D expenditures to assets. *Firm Size* is the natural log of net sales. All other variables are described in Table 3. Each model includes industry and year fixed-effects. All p-values are computed using robust Rogers (1993) firm-clustered standard errors.

	Obtain a New Major Customer (t+1)		**Obtain a New Major Customer (t+1)**		**Δ in # of Major Customers (t+1) - (t-1)**		**Initiate New Joint Venture (t+1)**		**Initiate New Joint Venture (t+1)**		**Δ in # of Active Joint Ventures (t+1) - (t-1)**		**Δ in Total # of Business Venture Partners (t+1) - (t-1)**		**Δ in Total # of Government Venture Partners (t+1) - (t-1)**	
	(1)		**(2)**		**(3)**		**(4)**		**(5)**		**(6)**		**(7)**		**(8)**	
	Estimate	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**
Intercept	-2.866	0.00	-2.945	0.00	0.512	0.00	-7.659	0.00	-7.907	0.00	-0.926	0.00	-1.421	0.00	-0.021	0.32
CEO Indiscretion	-1.368	0.06			-0.285	0.01	-1.553	0.03			-0.222	0.02	-0.367	0.01	-0.016	0.22
CEO Reputation Costs			-3.128	0.03					-6.529	0.30						
CEO Disruption Costs			-0.262	0.42					-1.692	0.32						
Customer Base	0.181	0.00	0.181	0.00	-0.297	0.00	0.059	0.00	0.060	0.00	0.016	0.00	0.024	0.00	0.000	0.87
Alliance Experience	-0.001	0.71	-0.001	0.70	0.000	0.84	0.030	0.00	0.030	0.00	0.026	0.00	0.038	0.00	0.003	0.00
Technical Intensity	3.666	0.00	3.683	0.00	2.020	0.00	0.962	0.40	0.958	0.40	0.405	0.07	0.723	0.04	0.010	0.74
Tobin's Q	-0.035	0.13	-0.035	0.13	-0.021	0.02	0.026	0.39	0.027	0.37	0.019	0.09	0.034	0.09	0.003	0.09
ROA	-0.238	0.24	-0.231	0.25	0.090	0.41	-0.765	0.01	-0.756	0.01	-0.205	0.00	-0.356	0.00	-0.024	0.01
Firm Size	-0.045	0.10	-0.047	0.09	-0.016	0.21	0.578	0.00	0.575	0.00	0.122	0.00	0.190	0.00	0.005	0.00
Firm Age	0.000	0.96	0.000	0.94	0.000	0.66	-0.004	0.10	-0.004	0.10	-0.001	0.03	-0.001	0.25	0.000	0.89
Family Managed Firm	-0.001	0.99	-0.003	0.97	-0.010	0.75	-0.044	0.64	-0.050	0.59	0.030	0.14	0.058	0.06	0.003	0.18
CAPX	0.646	0.00	0.642	0.00	-0.039	0.77	0.772	0.01	0.769	0.01	0.033	0.65	0.160	0.22	0.006	0.56
Leverage	-0.510	0.00	-0.506	0.00	-0.079	0.41	-0.344	0.16	-0.327	0.18	-0.200	0.00	-0.339	0.00	-0.026	0.00
CEO Ownership	0.001	0.80	0.001	0.85	0.001	0.72	-0.011	0.19	-0.012	0.17	0.000	0.90	0.000	0.99	0.000	0.64
Outside Director Own.	-0.020	0.06	-0.021	0.06	-0.007	0.05	0.005	0.66	0.005	0.66	0.002	0.24	0.005	0.11	0.001	0.10
Diversification	0.005	0.76	0.005	0.77	0.004	0.65	0.073	0.00	0.073	0.00	0.017	0.00	0.017	0.06	0.000	1.00
Poor Monitoring Index	-0.053	0.14	-0.053	0.14	-0.017	0.31	0.092	0.03	0.092	0.03	0.018	0.11	0.020	0.22	0.002	0.16
L-R / F- Stat	684.85	0.00	681.50	0.00	31.99	0.00	2348.01	0.00	2343.77	0.00	26.24	0.00	23.49	0.00	4.04	0.00
R^2	0.0882		0.0387		0.1706		0.0476		0.0135		0.2682		0.2627		0.1140	
N	15,950		15,950		15,950		15,950		15,950		15,950		15,950		15,950	

Table 8
Margin Response to the Product Market Discipline for Managerial Indiscretions

This table presents the impact of managerial indiscretions upon firm operating performance during the fiscal year the indiscretion is disclosed using the universe of firms listed in EXECUCOMP from 1996 to 2012. The dependent variable in models (1) to (3), *Abnormal Δ OROA (t)-(t-1)*, is the abnormal change in operating return on assets (OROA) using the procedure outlined in Barber and Lyon (1996) [their model 8]. The dependent variable in models (4) to (6), *Abnormal Δ Profit Margin (t)-(t-1)*, is the abnormal change in operating return on sales (OROS) using the same procedure. The key independent variable of interest, *CEO Indiscretion*, is a (0,1) indicator variable which takes on the value of '1' if a CEO indiscretion is disclosed during the fiscal year and '0' otherwise. *CEO Reputation Costs* and *CEO Disruption Costs* are the reputational and disruption costs normalized by sales described in Table 2 for CEO indiscretions, where the direct costs are rescaled by multiplying by 1,000. *Firm Size* is the natural log of net sales. All other variables are defined in Table 3. Each model includes industry and year fixed-effects. All p-values are computed using robust Rogers (1993) firm-clustered standard errors.

	Abnormal Δ OROA (t) - (t-1)						**Abnormal Δ Profit Margin (t) - (t-1)**					
	(1)		**(2)**		**(3)**		**(4)**		**(5)**		**(6)**	
	Estimate	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**
Intercept	-2.329	0.00	-1.391	0.11	-2.863	0.00	11.257	0.00	14.490	0.00	9.715	0.00
Indiscretion	-0.822	0.10					-1.815	0.16				
CEO Indiscretion			-1.734	0.02					-5.004	0.04		
CEO Reputational Costs					-7.430	0.00					-27.102	0.00
CEO Disruption Costs					-0.081	0.17					-0.114	0.26
Firm Size	0.319	0.00	0.317	0.00	0.353	0.00	0.740	0.00	0.735	0.00	0.719	0.00
Firm Age	-0.001	0.67	-0.001	0.68	0.001	0.78	0.005	0.30	0.005	0.30	0.005	0.28
Family Managed Firm	0.204	0.05	0.202	0.05	0.212	0.04	-0.059	0.80	-0.057	0.80	-0.076	0.74
CAPX	-2.013	0.00	-2.014	0.00	-1.969	0.00	-2.332	0.07	-2.334	0.07	-2.365	0.07
Leverage	-1.908	0.00	-1.904	0.00	-1.825	0.00	-5.882	0.00	-5.868	0.00	-5.792	0.00
CEO Ownership	-0.004	0.64	-0.004	0.67	-0.009	0.31	0.002	0.89	0.004	0.81	0.005	0.74
Outside Director Ownership	0.036	0.02	0.037	0.02	0.041	0.01	0.027	0.32	0.027	0.30	0.027	0.31
Diversification	-0.049	0.04	-0.049	0.04	-0.100	0.00	-0.074	0.14	-0.074	0.14	-0.077	0.12
Poor Monitoring Index	-0.139	0.02	-0.139	0.02	-0.041	0.09	-0.119	0.32	-0.116	0.33	-0.112	0.34
F-Statistic	99.6	0.00	99.39	0.00	100.10	0.00	769.7518	0.00	766.887	0.00	749.01	0.00
R^2	0.0128		0.0129		0.0143		0.0173		0.0177		0.0190	
N	15,950		15,950		15,950		15,950		15,950		15,950	

Table 9
Managerial Indiscretions, Shareholder Class Action Lawsuits, and Fraud

This table presents logistic regressions which estimate the propensity for malfeasance using the universe of firms listed in EXECUCOMP from 1996 to 2012. In Panel A, the dependent variable in each logistic regression model, *Violation Period Class Action Lawsuit*, is a (0,1) indicator denoting that the firm commits a violation in the year of the indiscretion or in the two years following the announcement that becomes the target of a class action lawsuit. In Panel B, the dependent variable in each logistic regression model, *Violation Period Fraud*, is a (0,1) indicator of whether the firm allegedly commits fraud in the year of the indiscretion or in the two years following the announcement that becomes the subject of a DOJ or SEC investigation. The key independent variable of interest, *Indiscretion*, is a (0,1) indicator variable which takes on the value of '1' if a managerial indiscretion is disclosed during the fiscal year and '0' otherwise. *CEO Indiscretion* and *Non-CEO Indiscretion* indicate whether the event is perpetrated by the firm's CEO or a junior executive / director, respectively. *Reputation Costs* and *Disruption Costs* are the reputational and disruption costs normalized by sales described in Table 2, where the direct costs are rescaled by multiplying by 1,000. *Industry Legal Exposure* is an indicator variable of whether the firm's industry is targeted by greater than the median number of class action lawsuits during the sample period. *Retail Firm*, *Technology Firm*, and *Regulated Firm* are indicator variables of whether the firm is in retail, technology, or regulated industries as defined by Field, Lowry, and Shu (2005). *Firm Size* is the natural log of net sales. *Market-Adj Stock Return* is the annual return on the firm's common stock for the period ending with the fiscal year-end, net of the CRSP value-weighted index. *Average Volume* is the average daily trading volume in millions of shares for the firm's common stock during the fiscal year. *Discretionary Accruals* is the discretionary portion of total current accruals as defined in Teoh, Welch, and Wong (1998). All other variables are defined in Table 3. Each model includes year fixed-effects (panel B models also include industry fixed-effects); p-values are computed using robust Rogers (1993) firm-clustered standard errors.

Panel A: Shareholder Class Action Lawsuits

	Violation Period Class Action Lawsuit							
	(1)		(2)		(3)		(4)	
	Estimate	p-value	Estimate	p-value	Estimate	p-value	Estimate	p-value
Intercept	-6.737	0.00	-6.758	0.00	-6.763	0.00	-6.715	0.00
Indiscretion	0.393	0.10						
CEO Indiscretion			0.757	0.04	0.762	0.04		
Non-CEO Indiscretion					0.198	0.51		
Reputational Costs							0.656	0.10
Disruption Costs							0.042	0.77
Industry Legal Exposure	0.584	0.04	0.584	0.04	0.584	0.04	0.584	0.04
Retail Firm	-0.213	0.38	-0.211	0.38	-0.211	0.38	-0.214	0.37
Technology Firm	0.439	0.01	0.437	0.01	0.438	0.01	0.437	0.01
Regulated Firm	-0.232	0.37	-0.231	0.37	-0.232	0.37	-0.231	0.37
Firm Size	0.269	0.00	0.272	0.00	0.271	0.00	0.272	0.00
Firm Age	-0.015	0.00	-0.015	0.00	-0.015	0.00	-0.015	0.00
Leverage	0.626	0.11	0.631	0.11	0.628	0.11	0.635	0.11
Market-Adj Stock Return	0.217	0.00	0.217	0.00	0.217	0.00	0.216	0.00
Average Volume	0.000	0.00	0.000	0.00	0.000	0.00	0.000	0.00
CEO-Chairman	0.199	0.06	0.197	0.06	0.198	0.06	0.195	0.06
Poor Monitoring Index	-0.006	0.93	-0.007	0.91	-0.007	0.91	-0.005	0.94
Likelihood Ratio	594.52	0.00	595.60	0.00	596.09	0.00	592.14	0.00
Pseudo R^2	0.0599		0.0488		0.0470		0.0290	
N	15,950		15,950		15,950		15,950	

Panel B: Fraud

	Violation Period Fraud							
	(1)		(2)		(3)		(4)	
	Estimate	p-value	Estimate	p-value	Estimate	p-value	Estimate	p-value
Intercept	-6.725	0.00	-7.215	0.00	-7.231	0.00	-7.117	0.00
Indiscretion	0.891	0.00						
CEO Indiscretion			1.211	0.01	1.230	0.01		
Non-CEO Indiscretion					0.719	0.06		
Reputational Costs							2.118	0.00
Disruption Costs							-0.742	0.20
Firm Size	0.443	0.00	0.465	0.00	0.460	0.00	0.472	0.00
Firm Age	-0.007	0.15	-0.007	0.20	-0.007	0.21	-0.007	0.20
Leverage	-0.196	0.68	0.455	0.34	0.447	0.35	0.470	0.33
Market-Adj Stock Return	0.162	0.00	0.134	0.02	0.129	0.03	0.132	0.02
Average Volume	-0.001	0.88	-0.018	0.21	0.000	0.19	-0.018	0.21
Discretionary Accruals	0.062	0.00	0.051	0.00	0.052	0.00	0.050	0.01
CEO-Chairman	0.160	0.32	0.125	0.44	0.128	0.43	0.123	0.45
CEO Ownership	-0.019	0.29	-0.013	0.43	-0.013	0.42	-0.012	0.46
CEO Age	-0.036	0.00	-0.033	0.01	-0.033	0.01	-0.033	0.01
CEO Tenure	0.024	0.11	0.024	0.12	0.024	0.11	0.024	0.12
Poor Monitoring Index	-0.002	0.98	0.020	0.82	0.019	0.83	0.019	0.83
Likelihood Ratio	799.15	0.00	863.29	0.00	867.18	0.00	867.06	0.00
Pseudo R^2	0.0489		0.0256		0.0768		0.0107	
N	15,950		15,950		15,950		15,950	

Table 10
Managerial Indiscretions and Earnings Management

This table presents evidence on the relation between managerial indiscretions and earnings management using the universe of firms listed in EXECUCOMP from 1996 to 2012. The dependent variable in OLS models (1) through (3) is the magnitude of *Discretionary Current Accruals* as defined in Teoh, Welch, and Wong (1998) and in OLS model (5) is the magnitude of *Performance-Adjusted Discretionary Total Accruals* as in Kothari, Leone, and Wasley (2005) where the first stage model used to estimate non-discretionary total accruals is augmented to include operating performance. The dependent variable in logistic regression models (4) and (6) is a (0,1) indicator of whether the discretionary current accruals in models (1) through (3) or performance-adjusted discretionary total accruals in model (5) were *managed to meet* analyst expectations following Koh, Matsumoto, and Rajgopal (2008).The key independent variable of interest, *Indiscretion*, is a (0,1) indicator variable which takes on the value of '1' if a managerial indiscretion is disclosed during the fiscal year and '0' otherwise. *CEO Indiscretion* indicates whether the event is perpetrated by the firm's CEO. *Reputation Costs* and *Disruption Costs* are the reputational and disruption costs normalized by sales described in Table 2, where the direct costs are rescaled by multiplying by 1,000. *Delaware Incorporation* is an indicator variable of whether the firm is incorporated in Delaware. *Firm Size* is the natural log of net sales. All other variables are defined in Table 3. Each model includes industry and year fixed-effects; p-values are computed using robust Rogers (1993) firm-clustered standard errors.

	Discretionary Current Accruals						Manage to Meet Using Discretionary Current Accruals		Performance-Adjusted Discretionary Total Accruals		Manage to Meet Using Performance-Adjusted Total Accruals	
	(1)		(2)		(3)		(4)		(5)		(6)	
	Estimate	p-value	Estimate	p-value	Estimate	p-value	Estimate	p-value	Estimate	p-value	Estimate	p-value
Intercept	0.121	0.00	0.089	0.02	0.146	0.00	0.862	0.00	0.045	0.09	-0.649	0.00
Indiscretion	0.027	0.07										
CEO Indiscretion			0.058	0.03			0.448	0.10	0.031	0.08	0.594	0.03
Reputational Costs					0.1616	0.00						
Disruption Costs					-1.6196	0.01						
CEO-Chairman	0.005	0.23	0.005	0.23	0.005	0.24	0.021	0.56	0.005	0.12	0.016	0.68
CEO Ownership	0.001	0.03	0.001	0.03	0.001	0.03	-0.005	0.11	0.001	0.05	-0.007	0.05
CEO Age	-0.001	0.00	-0.001	0.00	-0.001	0.00	0.002	0.34	0.000	0.31	0.003	0.29
CEO Tenure	0.000	0.60	0.000	0.58	0.000	0.59	-0.006	0.05	0.000	0.18	-0.001	0.85
Poor Monitoring Index	-0.001	0.62	-0.001	0.62	-0.001	0.65	0.023	0.29	-0.001	0.59	0.013	0.58
Delaware Incorporation	0.015	0.00	0.015	0.00	0.015	0.00	-0.011	0.74	0.010	0.00	0.005	0.89
Firm Size	-0.005	0.01	-0.005	0.01	-0.005	0.01	-0.079	0.00	-0.004	0.01	-0.044	0.01
ROA	-0.020	0.56	-0.022	0.53	-0.022	0.53	1.025	0.00	-0.044	0.02	0.329	0.14
Tobin's Q	0.010	0.00	0.010	0.00	0.010	0.00	0.023	0.16	0.010	0.00	-0.014	0.42
Leverage	0.013	0.42	0.012	0.42	0.013	0.40	0.161	0.11	-0.008	0.46	0.182	0.11
F-Stat / Likelihood Ratio	138.46	0.00	138.73	0.00	136.11	0.00	17.12	0.00	162.69	0.00	8.27	0.00
R^2 / Pseudo R^2	0.1382		0.1383		0.1390		0.0134		0.1190		0.0166	
N	15,950		15,950		15,950		15,660		15,945		15,660	

Table 11
Managerial Indiscretions and CEO Discipline

This table presents a logistic regression for the determinants for CEO turnover and an OLS regression for the change in CEO pay using the universe of firms listed in EXECUCOMP from 1996 to 2012. The dependent variable in models (1) and (2) is a (0,1) indicator variable signifying *Forced CEO Turnover* during the fiscal year, where forced is defined as in Parrino (1997). The dependent variable in models (3) and (4) is the Δ in *CEO Pay* (salary and bonus). *CEO Indiscretion* is a (0,1) indicator variables which takes on the value of '1' if a CEO indiscretion is disclosed during the fiscal year and '0' otherwise. *CEO Reputation Costs* and *CEO Disruption Costs* are the reputational and disruption costs normalized by sales described in Table 2 for CEO indiscretions, where the direct costs are rescaled by multiplying by 1,000. *Stock Return* is the firm's net-of market stock return during the fiscal year. *CEO Age > 60* is a (0,1) indicator of whether the CEO is older than 60 years old. *Firm Size* is the natural log of net sales. All variables are defined in Table 3. Each model includes industry and year fixed-effects; p-values are computed using robust Rogers (1993) firm-clustered standard errors.

	Forced CEO Turnover				**Δ CEO Pay**			
	(1)		**(2)**		**(3)**		**(4)**	
	Estimate	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**
Intercept	-0.864	0.13	-0.043	0.92	44.589	0.42	41.892	0.44
CEO Indiscretion	3.495	0.00			-388.477	0.01		
CEO Indiscretion x Stock Return	0.738	0.30			347.429	0.28		
CEO Reputational Costs			3.083	0.01			-576.59	0.05
CEO Disruption Costs			38.735	0.18			-4752.46	0.00
Poor Monitoring Index	0.044	0.44	0.062	0.27	4.246	0.49	3.787	0.53
Stock Return x Poor Monitoring Index	0.233	0.07	0.199	0.12	13.478	0.49	14.418	0.46
Stock Return	-0.958	0.00	-0.920	0.00	-66.972	0.01	-65.611	0.01
Firm Size	-0.085	0.02	-0.075	0.04	-11.694	0.00	-12.034	0.00
Leverage	0.245	0.31	0.275	0.26	74.026	0.00	74.271	0.00
Family Managed Firm	-0.160	0.10	-0.112	0.24	-5.611	0.53	-6.552	0.46
CEO Age	-0.021	0.01	-0.023	0.00	0.409	0.63	0.514	0.54
CEO Age > 60	-2.459	0.00	-2.389	0.00	7.131	0.61	6.856	0.63
CEO Tenure	0.005	0.57	0.003	0.74	0.308	0.67	0.297	0.67
CEO Ownership	-0.031	0.04	-0.019	0.18	-0.342	0.60	-0.575	0.39
Outside Director Ownership	0.021	0.03	0.021	0.03	-1.782	0.05	-1.752	0.06
Sample	All Observations				No CEO Turnover			
Likelihood Ratio / F-Stat	555.18	0.00	447.97	0.00	22.00	0.00	24.81	0.00
Pseudo R^2 / R^2	0.0468		0.0340		0.0845		0.0833	
N	15,950		15,950		12,444		12,444	

Table 12
Managerial Indiscretions and Director Election Results

This table presents firm- and calendar year-fixed effects regressions of the vote results for 86,836 director elections from 2,108 unique firms in the ISS Shareholder Voting database from 2003 to 2013. The dependent variable in each model is the *Percent "For" Votes* observed for each director where the percentage "For" is defined as the votes "For" divided by the sum of the votes "For" and "Against." The key independent variable of interest, *Indiscretion*, is an indicator variable which takes on the value of '1' if a managerial indiscretion is disclosed during the fiscal year at that firm and '0' otherwise. *Reputation Costs* and *Disruption Costs* are the reputational and disruption costs normalized by sales described in Table 2, where the direct costs are rescaled by multiplying by 1,000. *CEO Indiscretion* indicates whether the event is perpetrated by the firm's CEO, while *Board Member Indiscretion* indicates the offending executive is a member of the board of directors. *Board Leadership Indiscretion* indicates whether the offending executive is a member of the standing nominating, compensation, audit, or governance committees. *Firm Size* is the natural log of assets. *Industry-Adjusted ROA* is the return on assets reported by the company less the industry median ROA. *Classified Board* and *Poison Pill* indicate the firm has a staggered board or poison pill (as reported by RiskMetrics), respectively. *Board Holdings* is the aggregate percentage ownership of the common shares held by all of the directors on the board. *Litigation* indicates that the firm was the target of a shareholder class action lawsuit, while *Accounting Restatement* and *Non-Timely SEC Filing* indicate the firm restated its financials or failed to file with the Securities and Exchange Commission in a timely manner as reported by Audit Analytics. *Residual of ISS Rec.* is the residual of a linear probability model predicting a "For" recommendation by ISS for the director's election. *Vote-No Campaign* indicates the existence of such a campaign at the firm during the year. *Unequal Voting*, *Confidential Voting*, *Majority Voting* indicate unequal voting rights, a firm policy which prevents management from knowing how shareholders vote, and a requirement that directors are elected by majority vote, rather than a plurality vote, respectively. Each model includes firm / year fixed-effects and p-values are computed using robust Rogers (1993) firm-clustered standard errors.

	Percent "For" Votes									
	(1)		**(2)**		**(3)**		**(4)**		**(5)**	
	Estimate	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**
Indiscretion	-1.152	0.00								
Reputational Costs			-7.329	0.00						
Disruption Costs			-0.160	0.63						
CEO Indiscretion					-1.283	0.01				
Board Member Indiscretion							-1.168	0.00		
Board Leadership Indiscretion									-1.784	0.00
Firm Size	-0.264	0.00	-0.268	0.00	-0.269	0.00	-0.265	0.00	-0.276	0.00
Industry-Adjusted ROA	2.047	0.00	2.067	0.00	2.063	0.00	2.050	0.00	2.053	0.00
Classified Board	-0.527	0.00	-0.528	0.00	-0.525	0.00	-0.529	0.00	-0.524	0.00
Poison Pill	-0.530	0.00	-0.526	0.00	-0.524	0.00	-0.529	0.00	-0.526	0.00
Board Size	0.012	0.48	0.012	0.49	0.012	0.48	0.012	0.47	0.011	0.51
CEO-Chairman	-0.018	0.78	-0.012	0.86	-0.013	0.84	-0.014	0.83	-0.012	0.86
Percent Independent Directors	0.046	0.00	0.046	0.00	0.047	0.00	0.046	0.00	0.046	0.00
Board Holdings	-0.015	0.00	-0.015	0.00	-0.014	0.00	-0.015	0.00	-0.015	0.00
Litigation	-1.123	0.00	-1.118	0.00	-1.114	0.00	-1.126	0.00	-1.129	0.00
Accounting Restatement	-0.365	0.00	-0.364	0.00	-0.363	0.00	-0.365	0.00	-0.360	0.00
Non-Timely SEC Filing	-0.920	0.00	-0.917	0.00	-0.919	0.00	-0.919	0.00	-0.925	0.00
Residual of ISS Rec.	18.397	0.00	18.392	0.00	18.392	0.00	18.394	0.00	18.391	0.00
Vote-No Campaign	-2.306	0.00	-2.248	0.00	-2.246	0.00	-2.285	0.00	-2.268	0.00
Unequal Voting	-0.351	0.10	-0.330	0.12	-0.336	0.12	-0.349	0.10	-0.337	0.12
Confidential Voting	0.171	0.11	0.167	0.12	0.171	0.11	0.175	0.10	0.194	0.07
Majority Voting	1.243	0.00	1.246	0.00	1.246	0.00	1.242	0.00	1.245	0.00
F-Statistic	46.50	0.00	46.46	0.00	46.48	0.00	46.50	0.00	46.50	0.00
R^2	0.5395		0.5394		0.5394		0.5395		0.5395	
N	86,836		86,836		86,836		86,836		86,836	

Internet Appendix

A.1 Ambiguous Managerial Indiscretions and Confounding Events

As noted in the text, our sample includes 11 unique indiscretions (with 5 associated secondary firm observations), which could be ambiguously classified. For example, we classify a domestic violence incident fueled by illicit drugs as *Violence*, but this arguably could be classified as *Substance Abuse*. To test the sensitivity of our results to this choice, we exclude the ambiguous observations from our primary tests and report the results in Appendix A and B. The results are qualitatively similar to our primary findings.

Further, since the inclusion of the 63 confounding announcements into our event study is non-standard, we re-report our primary results from Tables 5 and 6 excluding these confounding events in Appendix C and D. As suggested by the *confounding event* estimate in Table 6, the results are generally more negative when these events are excluded from the analysis.

A.2 Managerial Indiscretions and Longer Term Firm Value

It is possible that the negative shareholder reactions reported in section 4.1 represent transitory shocks to firm value as investors exhibit a knee-jerk reaction to the announcement of the indiscretion. In this section we examine whether the reactions are permanently capitalized into the stock price or if there are reversals following an indiscretion. To do this, we test the relation between managerial indiscretions and long-run firm value by analyzing the time *t-1* to time *t* change in Tobin's Q over the year surrounding the indiscretion disclosure (where *t* is the fiscal year of the indiscretion announcement). This year-long period will also account for any issues we might have with misidentifying the announcement date, problems with confounding events, slow leakage of information about the indiscretion, etc.

Model (1) in Appendix E reveals that the announcement of an alleged indiscretion is significantly negatively related to the change in Tobin's Q. On average, firms demonstrate a 0.167 reduction in Q from *t-1* to *t*. At sample means, this implies an 8.9% loss in firm value. When the CEO is involved in an

indiscretion, the average decline in Q is a significant 0.210 or an 11.1% loss in firm value.[35] Thus, similar to the operating performance evidence, managerial indiscretions are associated with a more permanent deterioration in shareholder wealth. These findings are significant for the combined set of all executives, as well as for individual samples of CEO and non-CEO indiscretions.

A.3 Potential Self-Selection of Managerial Indiscretion Announcements

We are careful to recognize that news of managerial indiscretions may not arrive to the market randomly. For instance, an executive who commits sexual harassment or has a problem with alcohol could have been creating morale problems for years and compromised the careers of other managers, thereby impacting the firm's operating performance. Although our methodologies control for systematic differences between our sample firms by using changes in the dependent variable, addressing time-invariant self-selection, they also treat the disclosure of an indiscretion as temporally exogenous. If disgruntled employees opportunistically leak an indiscretion at a time when the manager is most vulnerable (i.e., when performance is poor), then there would be a systematic relation between the disclosure of an indiscretion and firm performance.[36] This leads to the classic self-selection problem identified by Heckman (1979) and failure to account for such endogenous self-selection essentially amounts to an omitted variables bias, causing the parameter estimates in the model to be inconsistent [Li and Prabhala (2007)].

We do not believe this to be a problem in our analysis. First, many of our observations occur because of arrest (drug use or violence) or the filing of a lawsuit by the aggrieved party rather than an internal tip. Moreover, we do not find prior poor performance to be significantly related to the disclosure of an indiscretion.[37] To be thorough, we correct for this type of endogeneity with the use of a two-stage self-selection model [Heckman (1979); Maddala (1983)]. We first estimate the propensity for the disclosure of an indiscretion using a probit regression and capture the inverse mills ratio, λ, from the first stage and

[35] In an unreported Barber, Lyon, Tsai (1999) Buy-and-Hold Abnormal Returns (BHARs) analysis, we similarly find BHARs of -13.76% for CEO indiscretions over the 250 trading days following the indiscretion disclosure.

[36] The coefficient on confounding event reported in in Table 6, however, suggests that the endogeneity of disclosure, if present, is positively biased. Thus, while plausible, empirical support for a negative bias is not observed.

[37] In some tests, the opposite is true. Firms with higher Tobin's Q are more likely to be associated with indiscretions.

then subsequently model the effect of an indiscretion on performance while including the λ in the second stage. The Heckman correction, λ, controls for the potential bias induced by systematic differences arising at indiscretion firms by specifically modeling the propensity for an indiscretion announcement on the basis of performance, firm value, governance, and ownership structure. Furthermore, this method has advantages in our application over other techniques, such as propensity score matching, since it also controls for selection based on "unobservables" not explicitly modeled in our first stage [Lennox, Francis, and Wang (2012)].

In order to successfully implement this method, we must properly identify the system. In the classic Heckman model, the first stage is identified due to the non-linear nature of the probit model and an instrument is not strictly required under the assumption of exogenous determinants and bivariate normality [Li and Prabhala (2007)]. However, if the first stage model contains endogenous explanatory variables (i.e., performance is a determinant of an indiscretion disclosure) or there is a violation of the normality assumption, then we require at least one exclusion variable in the first stage which is then left out of the second stage to properly identify the system. The exclusion variable(s) must be related to the probability of an indiscretion disclosure but unrelated to our change in performance variables.

As a matter of robustness, we choose two instrumental variables to add to our logistic regression model in Table 4 to perform our first stage estimation: the degree of religiosity at the corporate headquarters location [Hilary and Hui (2009)] and an indicator of whether the CEO of the firm is married.[38] Arguably, religious societies might be less tolerant of the behavior found in our sample and therefore an indiscretion is more likely to be disclosed (i.e., not covered up) in these regions. Hilary and Hui find religiosity, defined as the percentage of religious citizens in the corporate HQ county from the year 2000, is positively related to ROA.[39] However, we find no a priori reason that it should be related to abnormal performance *changes*

[38] We thank Nicolosi and Yore (2015) for sharing their data on CEO marital status.
[39] Religiosity is available from the American Religion Data Archive (ARDA) at the county level for only the years 1971, 1980, 1990, and 2000. Only the year 2000 data is appropriate for our 1996-2012 sample period.

(i.e., the level of religiosity in a single year does not induce a time trend in ROA or Q. Ostensibly, market efficiency prohibits a predictive annual trend in Q from such a readily observable trait as religiosity). Secondly, married CEOs could be less willing to engage in sexual harassment or have more to lose from activities, such as recreational drug use. Again, we have no prior reason to believe that marital status is related to performance changes. Empirically, religiosity is positively related to the probability of the disclosure of a managerial indiscretion (p-value = 0.00) but unrelated to either the change in abnormal operating performance or change in Tobin's Q (p-values of 0.45 and 0.91, respectively). Similarly, the married CEO indicator is negatively related to indiscretion disclosures (p-value = 0.06), but not significantly related to changes in OROA or Q. We note that both of these exclusions from the second stage model would have to be inappropriate to fail to identify the system.

In model (3) of Appendix E, we continue to find that CEO indiscretions are associated with a decline in Q even after accounting for the potential endogenous self-selection discussed above. We note that, while λ is significant, the bias runs counter to our results, as the coefficient is significantly positive. That is, indiscretions are announced when Tobin's Q values are typically increasing. This evidence is consistent with our *CAR* regressions, where we find that indiscretion announcements coincide with positive news releases (confounding events).

In model (1) of Appendix F, we also find that CEO indiscretions are associated with a decline in operating performance of 1.3%, even after accounting for endogenous self-selection. The parameter estimate on the Heckman correction, λ, is not significant in this model. This suggests that managerial indiscretions are not endogenously disclosed on the basis of operating performance.[40]

A.4 Difference-In-Difference Analysis around Managerial Indiscretion Announcements

[40] In our determinants model we use pre-event measures of operating performance. If we include contemporaneous measures of operating performance into our first stage as well, we continue to find a negative effect on OROA amounting to -1.5% (p-value = 0.0545).

If we fail to properly identify the system in the Heckman selection model, we run the risk of introducing more noise than signal to our tests due to multicollinearity between λ and our indiscretion indicator.[41] Therefore, we alternatively address the possibility that managerial indiscretion firms are systematically different than their non-indiscretion counterparts by implementing a firm fixed-effects difference-in-difference analysis of abnormal operating performance around the indiscretion announcement. In the regressions in Panel A of Appendix G, the estimate for the indiscretion indicator is interpreted as the difference in performance for indiscretion firms relative to non-indiscretion firms, absent a disclosure. The estimate for the time index reflects the annual change in performance for all firms. The interaction of these two is the amount of abnormal performance attributable to an indiscretion. We find a decline of 1.6% in operating performance using this method. There is no effect of a non-CEO indiscretion upon operating performance. Panel B of Appendix G reports similar results for the change in Tobin's Q.

A.5 Arrest Announcements

Finally, we isolate a subset of observations that, everything else equal, should not be disclosed by disgruntled employees or character assassins. Specifically, we examine the instances of managerial indiscretions that result in an arrest of the executive. Reviewing these cases, 73% of the arrests are the product of spontaneous action (e.g., HBO's Chris Albrecht's alleged assault on his girlfriend) and are disclosed by way of police activity rather than an investigative report. In model (2) of Appendix F, we find that operating performance declines by 2.2% (p-value = 0.0233) during the fiscal year in which these indiscretions are disclosed. We note that each of these specifications provides similar parameter estimates to our OLS result for the CEO. Similarly, as reported in model (5) of Appendix E, we find that arrested executives are associated with a 0.17 drop in Tobin's Q (p-value = 0.0985) over the one-year period.

A.6 Dishonesty Indiscretions, Malfeasance, and Director Elections

[41] As shown in the table, our variance inflation factors (VIF) are below the typical cutoff of 10 for multicollinearity problems.

The results in Tables 5 and 6 of the paper suggest that firm value losses (and particularly reputational losses) may be greater for dishonesty indiscretions. In Appendix H, we examine whether allegations of public dishonesty are any more related than other indiscretions to commissions of malfeasance, which result in subsequent corporate malfeasance. In each of the three panels, we estimate models similar to those in Tables 9 and 10, but replace the key variable of interest with indicators of whether the CEO allegedly committed a dishonesty-type indiscretion (*CEO Dishonesty Indiscretion*) or a sexual misadventure, substance abuse, or violence indiscretion (*Other CEO Indiscretion*). The results in Panels A and B indicate that dishonesty indiscretions are positively and significantly related to the commission of malfeasance that is ultimately targeted by shareholders in a lawsuit or a DOJ/SEC fraud investigation. They are also positively related to the level of discretionary accruals at the firm. Interestingly, the non-dishonesty indiscretions have a positive, but statistically insignificant effect on each of these three outcome variables.

In Table 12, we present evidence that managerial indiscretions are disciplined when shareholders vote for directors up for election. Specifically, directors up for election earn lower vote totals if there was an indiscretion disclosed under their watch. In Appendix I, we investigate whether the effects are more severe for cases alleging public dishonesty. The results corroborate our event study evidence in Table 5 and indicate that shareholders are particularly concerned with dishonest CEOs. Cases of CEO dishonesty precipitate vote totals that are about 3.7% lower for the directors monitoring that CEO. While the numeric magnitude of this result is unlikely to change the outcome of director elections, previous research shows that even small negative shifts in votes are associated with meaningful changes in board behavior including the repeal of staggered boards and poison pills and the lowering of executive compensation [Cai, Garner, and Walkling (2009)]. Shareholders appear relatively unconcerned about non-dishonesty indiscretions as the change in vote totals is insignificant.

Appendix A
Managerial Indiscretions and Firm Value (Excluding Ambiguous Indiscretions)

This table presents the impact of 309 managerial indiscretions on firm value as indicated by the 3-day and 5-day cumulative abnormal returns (CAR) at disclosure using standard event study methods [Brown and Warner (1985)] while excluding the 16 observations which could be ambiguously categorized (e.g., illicit drug induced domestic violence). Investor reactions are presented for the full sample, split by the investor reactions at the executive's *primary firm* and *secondary firm*, by executive title, and by turnover. *CEO* indicates whether the executive committing the indiscretion is the firm's chief executive officer, while *Non-CEO* denotes some other executive or director at the firm. *Turnover at Announcement* indicates the executive left within 30 days of the announcement, while *Executive Retained* indicates that the executive remains at the firm. Announcement returns are further disaggregated by *Sexual Misadventure*, *Substance Abuse*, *Violence*, and *Dishonesty* which are described in Table 2 and the text. *Shady Industry (Non-Compliance)* indicates the firm resides in an industry with a degree of regulatory non-compliance greater than the median for all industries [Kedia, Luo, and Rajgopal (2016)], while *Shady Industry (BPI)* denotes firms in sectors with grand bribery scores less than the median value of Transparency International's 2011 Bribe Payers Index (BPI) [Karpoff, Lee, and Martin (2015)]. P-values using Student's t tests and non-parametric Wilcoxon signed-rank tests are reported in parentheses.

		(-1,+1) CAR		(-2,+2) CAR	
	N	**Mean**	**Median**	**Mean**	**Median**
Overall Announcement Returns					
Full Sample	309	-1.45%	-0.57%	-1.63%	-0.62%
		(0.00)	(0.00)	(0.00)	(0.00)
Announcement Returns by Primary v. Secondary Firm					
Primary Firm	208	-2.06%	-0.96%	-2.15%	-0.92%
		(0.00)	(0.00)	(0.00)	(0.00)
Secondary Firm	101	-0.20%	-0.39%	-0.55%	-0.40%
		(0.66)	(0.44)	(0.32)	(0.24)
Announcement Returns by Title					
CEO	110	-3.71%	-2.05%	-3.59%	-2.31%
		(0.00)	(0.00)	(0.00)	(0.00)
Non-CEO	199	-0.21%	-0.29%	-0.54%	-0.37%
		(0.65)	(0.39)	(0.32)	(0.26)
Announcement Returns by Turnover					
Turnover at Announcement	86	-1.96%	-0.88%	-1.84%	-0.62%
		(0.03)	(0.01)	(0.03)	(0.02)
Executive Retained	223	-1.26%	-0.54%	-1.54%	-0.62%
		(0.00)	(0.00)	(0.01)	(0.02)
Announcement Returns by Indiscretion Type					
Sexual Misadventure	148	-0.37%	-0.40%	-0.30%	-0.48%
		(0.39)	(0.15)	(0.56)	(0.29)
Substance Abuse	34	-0.67%	-0.27%	-0.56%	-0.19%
		(0.27)	(0.99)	(0.49)	(0.78)
Violence	22	-2.11%	-2.03%	-2.76%	-2.91%
		(0.03)	(0.04)	(0.00)	(0.00)
Dishonesty	105	-3.10%	-1.18%	-3.61%	-0.77%
		(0.00)	(0.00)	(0.00)	(0.01)
Announcement Returns by Shady Industry					
Shady Industry (Non-Compliance)	157	-1.06%	-0.40%	-0.79%	-0.06%
		(0.06)	(0.06)	(0.24)	(0.49)
Non-Shady Industry (Non-Compliance)	152	-1.86%	-0.99%	-2.48%	-1.26%
		(0.00)	(0.00)	(0.00)	(0.00)
Shady Industry (BPI)	141	-1.19%	-0.54%	-1.79%	-0.52%
		(0.10)	(0.09)	(0.05)	(0.09)
Non-Shady Industry (BPI)	168	-1.68%	-0.63%	-1.49%	-0.77%
		(0.00)	(0.00)	(0.01)	(0.01)

Appendix B
Managerial Indiscretions and Firm Value Regressions (Excluding Ambiguous Indiscretions)

This table presents regressions of the (-1,+1) cumulative abnormal returns (CAR) at the indiscretion announcement for our sample of 309 managerial indiscretions [model (1)] while excluding the 16 observations which could be ambiguously categorized (e.g., illicit drug induced domestic violence). Models (2)-(5) are run on subsets stratified by the indiscretion category. *Sexual Misadventure*, *Violence*, and *Dishonesty* denote the category of indiscretion and are described in Table 2 and the text. Models (6) and (7) bifurcate this sample on the basis of whether the firm is in a *Shady Industry* or *Non-Shady Industry*, respectively, where shady industry is identified by non-compliance with federal regulations [Kedia, Luo, and Rajgopal (2016)] or by Transparency International's Bribe Payers [Karpoff, Lee, and Martin (2015)]. *Disruption Costs* are the direct disruption costs defined in Table 2 normalized by sales. *TO at Announcement* indicates the executive left the firm at the time of the announcement. *With Subordinate* indicates that the indiscretion involved another employee of the firm. *Founding Exec* indicates the executive is a member of the founding family. *Confounding Event* indicates that the firm announces some other event that is generally regarded as influencing stock returns (e.g., earnings guidance, mergers, new product announcements, etc). *Firm Size* is the natural log of net sales. *Market-Adj Return* is the firm's net-of-market stock return for the 250 trading days preceding the indiscretion. All other variables are defined in Tables 2 and 3.

(-1,+1) Cumulative Abnormal Return (CAR)

	(1)		(2)		(3)		(4)		(5)		(6)		(7)		(8)		(9)	
	Estimate	p-value	Estimate	p-value	Estimate	p-value	Estimate	p-value	Estimate	p-value	Estimate	p-value	Estimate	p-value	Estimate	p-value	Estimate	p-value
Intercept	-0.006	0.80	-0.008	0.67	-0.104	0.06	-0.010	0.87	-0.018	0.61	0.002	0.96	0.001	0.98	-0.065	0.38	-0.002	0.93
CEO	-0.032	0.00	-0.029	0.00	-0.018	0.29	-0.003	0.92	-0.059	0.02	-0.027	0.03	-0.041	0.00	-0.004	0.89	-0.036	0.00
Disruption Costs	-0.926	0.03	-4.968	0.02	-5.715	0.24	9.309	0.22	-0.602	0.45	-1.820	0.00	0.345	0.56	-11.341	0.00	0.001	0.91
Sexual Misadventure	-0.002	0.90									0.030	0.22	-0.032	0.17	-0.028	0.58	-0.001	0.94
Violence	-0.023	0.24									0.006	0.81	-0.028	0.36	-0.062	0.32	-0.016	0.46
Dishonesty	-0.036	0.03									0.005	0.82	-0.066	0.00	-0.069	0.18	-0.036	0.06
With Subordinate	-0.007	0.57									0.004	0.79	-0.012	0.46	-0.007	0.84	-0.003	0.81
TO at Announcement	0.002	0.83	0.025	0.02	0.061	0.09	-0.008	0.84	-0.028	0.18	-0.010	0.43	0.010	0.45	0.030	0.22	-0.008	0.46
Arrest	-0.012	0.34	0.002	0.91	0.021	0.23	-0.015	0.58	-0.045	0.14	0.015	0.39	-0.041	0.02	-0.096	0.01	-0.006	0.70
Repeat Offender	0.005	0.59	0.005	0.56	0.022	0.15	0.009	0.79	0.039	0.27	0.005	0.72	-0.001	0.94	0.026	0.31	0.001	0.91
Founding Family Exec	-0.002	0.88	0.007	0.59	0.028	0.17	-0.055	0.29	-0.021	0.58	-0.020	0.22	0.015	0.36	-0.021	0.54	0.003	0.81
Confounding Event	0.024	0.02	0.034	0.00	0.038	0.06	0.053	0.20	0.005	0.86	-0.004	0.74	0.053	0.00	0.014	0.60	0.017	0.18
Poor Monitoring Index	-0.001	0.90	0.005	0.28	0.015	0.08	0.004	0.68	-0.002	0.88	-0.002	0.71	0.007	0.23	0.008	0.51	0.001	0.88
Firm Size	0.002	0.34	-0.001	0.77	0.004	0.31	-0.002	0.80	0.002	0.62	0.000	0.90	0.001	0.64	0.009	0.13	0.001	0.61
ROA	-0.037	0.00	-0.020	0.21	-0.197	0.19	0.119	0.04	-0.052	0.02	-0.022	0.20	-0.019	0.19	-0.065	0.00	-0.020	0.14
Tobin's Q	0.001	0.19	0.000	0.88	0.005	0.56	0.002	0.73	0.001	0.61	-0.002	0.18	0.003	0.01	0.005	0.05	0.002	0.13
Market-Adj Return	0.005	0.55	0.001	0.88	0.030	0.13	0.056	0.11	0.010	0.65	0.023	0.06	-0.005	0.72	0.003	0.91	0.014	0.13
Sample	All Indiscretions		Sexual Misadventure		Substance Abuse		Violence		Dishonesty		Shady Industry (Non-Compliance)		Non-Shady Industry (Non-Compliance)		Shady Industry (BPI)		Non-Shady Industry (BPI)	
F-Statistic	4.04	0.00	3.44	0.00	1.74	0.13	2.35	0.10	2.39	0.01	3.55	0.00	4.01	0.00	4.80	0.00	2.39	0.00
R^2	0.1814		0.2343		0.4980		0.7582		0.2376		0.2888		0.3223		0.3823		0.2019	
N	309		148		34		22		105		157		152		141		168	

Appendix C
Managerial Indiscretions and Firm Value (Excluding Confounding Events)

This table presents the impact of 262 managerial indiscretions on firm value as indicated by the 3-day and 5-day cumulative abnormal returns (*CAR*) at disclosure using standard event study methods [Brown and Warner (1985)] while excluding the 63 confounding events. Investor reactions are presented for the full sample, split by the investor reactions at the executive's *primary firm* and *secondary firm*, by executive title, and by turnover. *CEO* indicates whether the executive committing the indiscretion is the firm's chief executive officer, while *Non-CEO* denotes some other executive or director at the firm. *Turnover at Announcement* indicates the executive left within 30 days of the announcement, while *Executive Retained* indicates that the executive remains at the firm. Announcement returns are further disaggregated by *Sexual Misadventure*, *Substance Abuse*, *Violence*, and *Dishonesty* which are described in Table 2 and the text. *Shady Industry (Non-Compliance)* indicates the firm resides in an industry with a degree of regulatory non-compliance greater than the median for all industries [Kedia, Luo, and Rajgopal (2016)] while *Shady Industry (BPI)* denotes firms in sectors with grand bribery scores less than the median value of Transparency International's 2011 Bribe Payers Index (BPI) [Karpoff, Lee, and Martin (2015)]. P-values using Student's t tests and non-parametric Wilcoxon signed-rank tests are reported in parentheses.

		(-1,+1) CAR		(-2,+2) CAR	
	N	**Mean**	**Median**	**Mean**	**Median**
Overall Announcement Returns					
Full Sample	262	-2.18%	-1.20%	-2.45%	-1.40%
		(0.00)	(0.00)	(0.00)	(0.00)
Announcement Returns by Primary v. Secondary Firm					
Primary Firm	178	-2.76%	-1.51%	-2.76%	-1.77%
		(0.00)	(0.00)	(0.00)	(0.00)
Secondary Firm	84	-0.93%	-0.56%	-1.71%	-1.07%
		(0.06)	(0.01)	(0.00)	(0.00)
Announcement Returns by Title					
CEO	93	-4.75%	-3.02%	-4.44%	-2.69%
		(0.00)	(0.00)	(0.00)	(0.00)
Non-CEO	169	-0.76%	-0.54%	-1.35%	-1.04%
		(0.15)	(0.00)	(0.02)	(0.00)
Announcement Returns by Turnover					
Turnover at Announcement	79	-2.50%	-1.18%	-2.30%	-1.37%
		(0.02)	(0.00)	(0.02)	(0.01)
Executive Retained	183	-2.04%	-1.21%	-2.51%	-1.45%
		(0.00)	(0.00)	(0.00)	(0.00)
Announcement Returns by Indiscretion Type					
Sexual Misadventure	121	-1.37%	-1.02%	-1.44%	-1.15%
		(0.00)	(0.00)	(0.00)	(0.00)
Substance Abuse	30	-0.94%	-0.39%	-0.86%	-0.49%
		(0.16)	(0.65)	(0.34)	(0.54)
Violence	23	-2.97%	-2.38%	-3.83%	-3.47%
		(0.00)	(0.00)	(0.00)	(0.00)
Dishonesty	88	-3.36%	-1.94%	-2.84%	-1.74%
		(0.00)	(0.00)	(0.00)	(0.00)
Announcement Returns by Shady Industry					
Shady Industry (Non-Compliance)	128	-1.24%	-0.74%	-0.91%	-0.47%
		(0.05)	(0.00)	(0.20)	(0.07)
Non-Shady Industry (Non-Compliance)	134	-3.07%	-1.49%	-3.92%	-1.83%
		(0.00)	(0.00)	(0.00)	(0.00)
Shady Industry (BPI)	115	-1.80%	-0.97%	-2.76%	-1.37%
		(0.01)	(0.00)	(0.00)	(0.00)
Non-Shady Industry (BPI)	147	-2.47%	-1.51%	-2.20%	-1.46%
		(0.00)	(0.00)	(0.00)	(0.00)

Appendix D

Managerial Indiscretions and Firm Value Regressions (Excluding Confounding Events)

This table presents regressions of the (-1,+1) cumulative abnormal returns (*CAR*) at the indiscretion announcement for our sample of 262 managerial indiscretions while excluding the 63 confounding events [model (1)]. Models (2)-(5) are run on subsets stratified by the indiscretion category. *Sexual Misadventure*, *Violence*, and *Dishonesty* denote the category of indiscretion and are described in Table 2 and the text. Models (6) and (7) bifurcate this sample on the basis of whether the firm is in a *Shady Industry* or *Non-Shady Industry*, respectively, where shady industry is identified by non-compliance with federal regulations [Kedia, Luo, and Rajgopal (2016)] or by Transparency International's Bribe Payers Index [Karpoff, Lee, and Martin (2015)]. *Disruption Costs* are the direct disruption costs defined in Table 2 normalized by sales. *TO at Announcement* indicates the executive left the firm at the time of the announcement. *With Subordinate* indicates that the indiscretion involved another employee of the firm. *Founding Family Exec* indicates the executive is a member of the founding family. *Confounding Event* indicates that the firm announces some other event that is generally regarded as influencing stock returns (e.g., earnings guidance, mergers, new product announcements, etc). *Firm Size* is the natural log of net sales. *Market-Adj Return* is the firm's net-of-market stock return for the 250 trading days preceding the indiscretion. All other variables are defined in Tables 2 and 3.

(-1,+1) Cumulative Abnormal Return (CAR)

	(1)		(2)		(3)		(4)		(5)		(6)		(7)		(8)		(9)	
	Estimate	p-value	Estimate	p-value	Estimate	p-value	Estimate	p-value	Estimate	p-value	Estimate	p-value	Estimate	p-value	Estimate	p-value	Estimate	p-value
Intercept	-0.005	0.85	-0.015	0.47	-0.097	0.11	-0.063	0.12	-0.037	0.37	0.043	0.22	-0.022	0.61	-0.061	0.46	0.008	0.74
CEO	-0.040	0.00	-0.031	0.01	-0.025	0.19	-0.042	0.09	-0.076	0.01	-0.032	0.02	-0.048	0.00	-0.014	0.63	-0.045	0.00
Disruption Costs	0.001	0.86	-4.816	0.04	-0.018	0.73	13.010	0.05	0.401	0.61	-1.625	0.01	0.003	0.75	-6.555	0.01	0.000	0.98
Sexual Misadventure	-0.009	0.66									0.024	0.37	-0.036	0.27	-0.039	0.47	-0.003	0.87
Violence	-0.025	0.29									-0.016	0.57	-0.031	0.39	-0.047	0.46	-0.019	0.35
Dishonesty	-0.043	0.04									0.003	0.91	-0.072	0.02	-0.070	0.21	-0.032	0.09
With Subordinate	-0.007	0.65									-0.005	0.76	-0.014	0.55	-0.005	0.90	-0.003	0.83
TO at Announcement	0.001	0.95	0.028	0.02	0.046	0.16	0.018	0.43	-0.031	0.22	-0.002	0.85	0.008	0.63	0.025	0.37	-0.004	0.71
Arrest	-0.023	0.13	0.006	0.82	0.023	0.21	-0.013	0.51	-0.078	0.05	0.003	0.89	-0.042	0.09	-0.125	0.00	-0.005	0.71
Repeat Offender	0.006	0.61	0.008	0.50	0.022	0.21	-0.049	0.15	0.047	0.28	0.004	0.79	0.006	0.75	0.022	0.45	0.008	0.47
Founding Family Exec	0.000	0.99	0.007	0.67	0.030	0.20	0.011	0.73	-0.016	0.72	-0.021	0.24	0.029	0.15	0.001	0.98	0.001	0.94
Poor Monitoring Index	-0.002	0.67	0.005	0.37	0.008	0.44	0.008	0.27	-0.003	0.84	-0.002	0.78	0.006	0.44	0.008	0.60	0.001	0.80
Firm Size	0.004	0.11	0.000	0.93	0.005	0.23	0.004	0.43	0.006	0.26	-0.004	0.17	0.005	0.18	0.011	0.09	-0.001	0.76
ROA	-0.024	0.07	-0.014	0.52	-0.078	0.66	0.148	0.00	-0.036	0.14	-0.018	0.26	-0.011	0.57	-0.049	0.00	-0.016	0.22
Tobin's Q	0.000	0.70	-0.001	0.79	0.000	1.00	0.005	0.21	0.000	0.89	-0.004	0.01	0.003	0.01	0.001	0.61	0.002	0.13
Market-Adj Return	0.008	0.47	-0.002	0.84	0.029	0.18	0.053	0.04	0.014	0.61	0.017	0.19	-0.001	0.96	0.022	0.43	0.005	0.59
Sample	All Indiscretions		Sexual Misadventure		Substance Abuse		Violence		Dishonesty		Shady Industry (Non-Compliance)		Non-Shady Industry (Non-Compliance)		Shady Industry (BPI)		Non-Shady Industry (BPI)	
F-Statistic	2.60	0.00	2.22	0.02	1.59	0.19	2.29	0.09	1.92	0.05	3.97	0.00	2.42	0.00	3.68	0.00	2.32	0.01
R^2	0.1369		0.1828		0.4923		0.6959		0.2176		0.3472		0.2354		0.3648		0.2065	
N	262		121		30		23		88		128		134		112		150	

Appendix E
Managerial Indiscretions and Long-Run Firm Value

This table presents the impact of managerial indiscretions upon long-run firm value during the fiscal year the indiscretion is disclosed using the universe of firms listed in EXECUCOMP from 1996 to 2012. The dependent variable in Panel A is Δ *Tobin's Q* from the fiscal year-end of the year immediately preceding the indiscretion announcement (t-1) to the year of the announcement (t). The key independent variable of interest, *Indiscretion*, *CEO Indiscretion*, and *Non-CEO Indiscretion* are (0,1) indicators of whether a managerial, CEO, or non-CEO indiscretion is disclosed during the fiscal year, respectively. *Arrest* indicates an indiscretion which results in an arrest of the executive. Δ indicates a change in the variable from fiscal year (t-1) to (t). *ROA* is the change in abnormal operating performance. *Firm Size* is the natural log of net sales. All other variables are defined in Table 3. Model 3 is run as a Heckman (1979) treatment effects model where λ is the inverse mills ratio captured from the first stage model predicting an indiscretion. Variance inflation factors (*VIF*) are reported as tests for multicollinearity. Each model includes industry and year fixed-effects. All p-values are computed using robust Rogers (1993) firm-clustered standard errors.

	Δ **Tobin's Q**									
	(1)		**(2)**		**(3)**		**(4)**		**(5)**	
	Estimate	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**
Intercept	-0.020	0.76	0.027	0.77	0.014	0.88	-0.187	0.00	-0.184	0.00
Indiscretion	-0.167	0.00								
CEO Indiscretion			-0.210	0.01	-0.315	0.00				
Non-CEO Indiscretion							-0.138	0.03		
Arrest									-0.171	0.10
Δ ROA	1.435	0.00	1.436	0.00	1.440	0.00	1.439	0.00	1.437	0.00
Δ Leverage	-0.567	0.00	-0.564	0.00	-0.564	0.00	-0.569	0.00	-0.567	0.00
Δ CAPX	0.000	0.41	0.000	0.38	0.000	0.46	0.000	0.42	0.000	0.36
Δ Diversification	-0.020	0.00	-0.019	0.00	-0.020	0.00	-0.019	0.00	-0.019	0.00
Δ Poor Monitoring Index	-0.014	0.09	-0.014	0.09	-0.023	0.01	-0.014	0.09	-0.014	0.09
Firm Age	0.039	0.00	0.040	0.00	0.031	0.00	0.040	0.00	0.040	0.00
Firm Size	-0.010	0.00	-0.010	0.00	0.006	0.12	-0.010	0.00	-0.010	0.00
Family Managed Firm	-0.001	0.91	-0.002	0.81	0.042	0.00	-0.002	0.83	-0.002	0.79
CEO Age	0.001	0.27	0.001	0.28	0.000	0.96	0.001	0.25	0.001	0.27
CEO Tenure	-0.001	0.19	-0.001	0.25	-0.003	0.00	-0.001	0.23	-0.001	0.27
CEO Ownership	-0.001	0.19	-0.001	0.16	0.002	0.05	-0.001	0.13	-0.001	0.12
Outside Director Ownership	0.000	0.92	0.000	0.90	0.000	0.93	0.000	0.93	0.000	0.89
λ					1.681	0.00				
VIF (CEO Indiscretion)					1.079					
VIF (λ)					2.564					
F-Statistic	122.01	0.00	121.51	0.00	115.87	0.00	121.61	0.00	121.37	0.00
R^2	0.0938		0.0934		0.0966		0.0933		0.0931	
N	15,950		15,950		15,950		15,950		15,950	

Appendix F
Self-Selection and Arrests for Operating Performance Tests

This table presents the impact of managerial indiscretions upon firm operating performance during the fiscal year the indiscretion is disclosed using the universe of firms listed in EXECUCOMP from 1996 to 2012. The dependent variable, *Abnormal Δ OROA (t)-(t-1)*, is the abnormal change in OROA using the procedure outlined in Barber and Lyon (1996) [their model 8]. *CEO Indiscretion*, is a (0,1) indicator of whether a CEO indiscretion is disclosed during the fiscal year. *Arrest* indicates an indiscretion which results in an arrest of the executive. *Firm Size* is the natural log of net sales. All other variables are defined in Table 3. Model 1 is run as a Heckman (1979) treatment effects model where λ is the inverse mills ratio captured from the first stage model predicting an indiscretion. Variance inflation factors (*VIF*) are reported as tests for multicollinearity. Model (2) is run as an OLS. Each model includes industry and year fixed-effects. All p-values are computed using robust Rogers (1993) firm-clustered standard errors.

	Abnormal Δ OROA (t) - (t-1)			
	(1)		**(2)**	
	Estimate	**p-value**	**Estimate**	**p-value**
Intercept	-1.449	0.06	-3.129	0.00
CEO Indiscretion	-1.276	0.10		
Arrest			-2.145	0.02
Firm Size	0.303	0.00	0.317	0.00
Firm Age	-0.001	0.80	-0.001	0.72
Family Managed Firm	0.187	0.05	0.203	0.05
CAPX	-2.072	0.00	-2.017	0.00
Leverage	-1.907	0.00	-1.907	0.00
CEO Ownership	-0.002	0.84	-0.005	0.58
Outside Director Ownership	0.045	0.01	0.037	0.02
Diversification	-0.037	0.10	-0.049	0.04
Poor Monitoring Index	-0.125	0.02	-0.140	0.02
λ	-0.147	0.48		
VIF (CEO Indiscretion)	1.465			
VIF (λ)	1.510			
F-Statistic	109.20	0.00	99.46	0.00
R^2	0.0135		0.0129	
N	15,950		15,950	

Appendix G
Difference-In-Difference Tests

This table presents the impact of managerial indiscretions upon operating performance and long-run firm value during the fiscal year the indiscretion is disclosed using the universe of firms listed in EXECUCOMP from 1996 to 2012. The research design is a difference-in-difference model with firm and year fixed-effects. The dependent variable in Panel A, *Abnormal OROA (t)*, is the abnormal operating return on assets [Barber and Lyon (1996), their model 4] and the time t observation is indicated by the (0,1) indicator *Time index*. The interaction of the indiscretion indicator and the time index is the amount of abnormal performance attributable to an indiscretion. The dependent variable in Panel B is *Tobin's Q* and the time *t* observation is indicated by the (0,1) indicator *Time index*. In the regressions, the estimate for the indiscretion indicator should be interpreted as the difference in Q for indiscretion firms relative to non-indiscretion firms, absent a disclosure. The estimate for the time index reflects the annual change in Q for all firms. The interaction of these two is the change in value attributable to an indiscretion. All p-values are computed using robust Rogers (1993) firm-clustered standard errors.

Panel A: Firm Fixed-Effects Difference-in-Difference in Operating Performance

	Abnormal OROA (t)					
	(1)		(2)		(3)	
	Estimate	p-value	Estimate	p-value	Estimate	p-value
Indiscretion x Time Index	-0.804	0.05				
Indiscretion	0.032	0.87				
CEO Indiscretion x Time Index			-1.619	0.01		
CEO Indiscretion			0.22	0.51		
Non-CEO Indiscretion x Time Index					-0.414	0.42
Non-CEO Indiscretion					-0.021	0.93
Time Index	0.48	0.00	0.476	0.00	0.473	0.00
F-Statistic	1.57	0.00	1.57	0.00	1.57	0.00
R^2	0.1106		0.1107		0.1104	
N	15,590		15,590		15,590	

Panel B: Firm Fixed-Effects Difference-in-Difference in Firm Value

	Tobin's Q					
	(1)		(2)		(3)	
	Estimate	p-value	Estimate	p-value	Estimate	p-value
Indiscretion x Time Index	-0.196	0.00				
Indiscretion	-0.067	0.43				
CEO Indiscretion x Time Index			-0.286	0.00		
CEO Indiscretion			0.015	0.93		
Non-CEO Indiscretion x Time Index					-0.153	0.02
Non-CEO Indiscretion					-0.092	0.32
Time Index	-0.045	0.00	-0.047	0.00	-0.047	0.00
F-Statistic	29.33	0.00	29.32	0.00	29.32	0.00
R^2	0.6943		0.6942		0.6943	
N	15,590		15,590		15,590	

Appendix H
Dishonesty Indiscretions, Shareholder Class Action Lawsuits, Fraud, and Earnings Management

This table presents logistic regressions which estimate the propensity for malfeasance using the universe of firms listed in EXECUCOMP from 1996 to 2012. In Panel A, the dependent variable in each logistic regression model, Violation Class Action Lawsuit, is a (0,1) indicator denoting that the firm commits a violation in the year of the indiscretion or in the two years following the announcement that becomes the target of a class action lawsuit. In Panel B, the dependent variable in each logistic regression model, Violation Fraud, is a (0,1) indicator of whether the firm allegedly commits Fraud in the year of the indiscretion or in the two years following the announcement that becomes the subject of a DOJ or SEC fraud investigation. The dependent variable in the OLS regression in Panel C is the magnitude of Discretionary Accruals discretionary current accruals as defined in Teoh, Welch, and Wong (1998). The key independent variables of interest, CEO Dishonesty Indiscretion and Other CEO Indiscretion indicate whether the CEO allegedly committed a dishonesty indiscretion or some other type of indiscretion, respectively. Industry Legal Exposure is an indicator variable of whether the firm's industry is targeted by greater than the median number of class action lawsuits during the sample period. Retail Firm, Technology Firm, and Regulated Firm are indicator variables of whether the firm is in retail, technology, or regulated industries as defined by Field, Lowry, and Shu (2005). Firm Size is the natural log of net sales. Market-Adj Stock Return is the annual return on the firm's common stock for the period ending with the fiscal year-end, net of the CRSP value-weighted index. Average Volume is the average daily trading volume in millions of shares for the firm's common stock during the fiscal year. Delaware Incorporation is an indicator variable of whether the firm is incorporated in Delaware. ROA is the net income return on assets. Tobin's Q is the market value of assets to their book value. Leverage is total debt to assets. All other variables are defined in Table 3. Each model includes year fixed-effects (panel B models also include industry fixed-effects); p-values are computed using robust Rogers (1993) firm-clustered standard errors.

Panel A: Shareholder Class Action Lawsuits			**Panel B: Fraud**			**Panel C: Earnings Management**		
	Violation Class Action Lawsuit			**Violation Fraud**			**Discretionary Accruals**	
	Estimate	**p-value**		**Estimate**	**p-value**		**Estimate**	**p-value**
Intercept	-6.742	0.00	Intercept	-7.211	0.00	Intercept	0.109	0.01
CEO Dishonesty Indiscretion	1.390	0.01	CEO Dishonesty Indiscretion	1.940	0.01	CEO Dishonesty Indiscretion	0.102	0.05
Other CEO Indiscretion	0.403	0.41	Other CEO Indiscretion	0.869	0.16	Other CEO Indiscretion	0.038	0.21
Industry Legal Exposure	0.584	0.04	Firm Size	0.466	0.00	CEO-Chairman	0.005	0.24
Retail Firm	-0.211	0.38	Firm Age	-0.007	0.20	CEO Ownership	0.001	0.03
Technology Firm	0.439	0.01	Leverage	0.448	0.35	CEO Age	-0.001	0.00
Regulated Firm	-0.228	0.38	Market-Adj Stock Return	0.134	0.02	CEO Tenure	0.000	0.59
Firm Size	0.273	0.00	Average Volume	0.000	0.21	Poor Monitoring Index	-0.001	0.61
Firm Age	-0.015	0.00	Discretionary Accruals	0.052	0.00	Delaware Incorporation	0.015	0.00
Leverage	0.624	0.11	CEO-Chairman	0.122	0.45	Firm Size	-0.005	0.01
Market-Adj Stock Return	0.218	0.00	CEO Ownership	-0.013	0.44	ROA	-0.022	0.53
Average Volume	0.000	0.00	CEO Age	-0.033	0.01	Tobin's Q	0.010	0.00
CEO-Chairman	0.196	0.06	CEO Tenure	0.024	0.12	Leverage	0.012	0.43
Poor Monitoring Index	-0.008	0.90	Poor Monitoring Index	0.020	0.82			
Likelihood Ratio	597.49	0.00	Likelihood Ratio	864.66	0.00	F-Statistic	134.41	0.00
Pseudo R^2	0.0472		Pseudo R^2	0.0767		R^2	0.1385	
N	15,950		N	15,950		N	15,950	

Appendix I
Dishonesty Indiscretions and Director Election Results

This table presents firm- and calendar year-fixed effects regressions of the vote results for 86,836 director elections from 2,108 unique firms in the ISS Shareholder Voting database from 2003-2013. The dependent variable in the OLS model is the Percent "For" Votes observed for each director where the percentage "For" is defined as the votes "For" divided by the sum of the votes "For" and "Against." The key independent variables of interest, CEO Dishonesty Indiscretion and Other CEO Indiscretion indicate whether the CEO allegedly committed a dishonesty indiscretion or some other type of indiscretion, respectively. Firm Size is the natural log of assets. Industry-Adjusted ROA is the return on assets reported by the company less the industry median ROA. Classified Board and Poison Pill indicates the firm has a staggered board or poison pill (as reported by RiskMetrics), respectively. Board Holdings is the aggregate percentage ownership of the common shares held by all of the directors on the board. Litigation indicates that the firm was the target of a shareholder class-action lawsuit while Accounting Restatement and Non-Timely SEC Filing indicate the firm restated their financials or failed to file with the Securities and Exchange Commission in a timely manner as reported by Audit Analytics. Residual of ISS Recommendation is the residual of a linear probability model predicting a "For" recommendation by ISS for the director's election. Vote-No Campaign indicates the existence of such a campaign at the firm during the year. Unequal Voting, Confidential Voting, Majority Voting indicate unequal voting rights, a firm policy which prevents management from knowing how shareholders vote, and a requirement that directors are elected by majority vote, rather than a plurality vote, respectively. Each model includes firm / year fixed-effects and p-values are computed using robust Rogers (1993) firm-clustered standard errors.

	Percent "For" Votes	
	(1)	
	Estimate	**p-value**
CEO Dishonesty Indiscretion	-3.687	0.00
Other CEO Indiscretion	0.151	0.82
Firm Size	-0.257	0.00
Industry-Adjusted ROA	2.058	0.00
Classified Board	-0.523	0.00
Poison Pill	-0.528	0.00
Board Size	0.012	0.48
CEO-Chairman	-0.017	0.79
Percent Outside Directors	0.046	0.00
Board Holdings	-0.014	0.00
Litigation	-1.121	0.00
Accounting Restatement	-0.355	0.00
Non-Timely SEC Filing	-0.924	0.00
Residual of ISS Recommendation	18.399	0.00
Vote-No Campaign	-2.247	0.00
Unequal Voting	-0.325	0.13
Confidential Voting	0.181	0.09
Majority Voting	1.242	0.00
F-Statistic	46.48	0.00
R^2	0.5395	
N	86,836	