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Explaining CEO Retention in Misreporting Firms

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ABSTRACT

We propose a framework that advances our understanding of Chief Executive Officer (CEO) retention decisions in misreporting firms. Consistent with economic intuition, outside directors are more likely to fire (retain) CEOs when retention (replacement) costs are high relative to replacement (retention) costs. When the decision is ambiguous because neither cost dominates, outside directors are more likely to retain the CEO when they both benefit from selling stock in the misreporting period. We show that joint abnormal selling captures director-CEO alignment incrementally to biographical overlap. This new proxy operationalizes information sharing and trust, making it useful for studying economic decision-making embedded in social relationships.

\textit{JEL classification:} G31; G32; G34; M40

\textit{Keywords:} CEO turnover, CFO turnover, fraud, restatements, insider trading, litigation costs, replacement costs

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