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### Political ideology of the board and CEO dismissal following financial misconduct

Uisung PARK  
*Syracuse University*

Warren BOEKER  
*University of Washington*

David GOMULYA  
*Singapore Management University, dgomulya@smu.edu.sg*

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# **POLITICAL IDEOLOGY OF THE BOARD AND CEO DISMISSAL FOLLOWING FINANCIAL MISCONDUCT**

## **RESEARCH SUMMARY**

Why do some boards refuse to take serious action against CEOs who have committed financial misconduct? Past work has directed attention to the antecedents of misconduct while largely overlooking this question. The relatively few studies that examined it have typically revolved around agency arguments. This study instead examines how the beliefs and values held by board members can influence their actions following financial misconduct. Focusing on political ideology, we argue that politically conservative boards are more likely to respond by dismissing the CEO than are liberal boards as the result of ideo-attribution and threat management tendencies. Using data from S&P 1500 firms that were involved with financial misconduct, we find support for our arguments while addressing sample-induced endogeneity and alternative explanations with additional analyses.

## **MANAGERIAL SUMMARY**

Despite criticism from stakeholders, the public, media, and policy makers, many firms do not take serious action against CEOs who have committed financial misconduct. Past studies have suggested that this is due to board structures (e.g., lack of board independence) or situations surrounding misconduct (e.g., severity of misconduct). We propose that political ideology, a set of beliefs and values, held by board members, influences whether firms dismiss their CEOs following financial misconduct. Examining S&P 1500 firms that were involved in financial misconduct, we find that politically conservative boards tend to dismiss their CEOs more often than do liberal boards, offering practical implications for how the ideology of board members can influence critical actions that they take.

## INTRODUCTION

Organizational misconduct can pose a significant material threat to organizations, destroying billions of dollars of market value and resulting in lasting damage to the firm's reputation and credibility (Devers *et al.*, 2009; Greve and Teh, 2016). Firm stakeholders and other observers generally expect an organization to deliver a strong response to the disclosure of misconduct, and past work has confirmed that organizations sometimes do take strong actions, such as dismissing the CEO (Desai, Hogan, and Wilkins, 2006). However, the puzzle is that in many cases boards have taken limited or no action toward the CEO, even when the misconduct is quite substantial (Beneish, Marshall, and Yang, 2017), resulting in criticism from the public, media, and policy makers (Economist, 2009; Fisher, 2009) that boards are deficient in their oversight role.

Past work on organizational misconduct has paid close attention as to why misconduct happens (e.g., Ashforth and Lange, 2016), but, as Palmer and his colleagues (2016) note, have paid little attention to the consequences of misconduct (Palmer, Greenwood, and Smith-Crowe, 2016). The few studies that have examined the consequences of misconduct have generally centered around two areas. The first focuses on agency-based explanations such as the role of board independence and the relationship between CEOs and their directors. For example, Gomulya and Boeker (2016) find that the positive link between financial restatement and CEO dismissal is influenced by director characteristics while Nguyen, Hagendorff, and Eshraghi (2016) suggest how the relationship between firm misconduct and dismissal is affected by board monitoring. The second approach takes a more situational view, examining how the severity of the misconduct, past firm performance, and media attention (Arthaud-Day *et al.*, 2006; Busenbark *et al.*, 2019; Wiersema and Zhang, 2013; Zavyalova *et al.*, 2016) influence the relationship between firm misconduct and CEO dismissal.

Within the broader corporate governance literature, reasons why boards choose to dismiss or protect CEOs typically revolve around established agency arguments, for example board independence (e.g., whether a board has more outside directors or an independent Chair) and loyalty to the CEO (e.g., whether the board member was appointed by the current CEO) (e.g., Crossland and Chen, 2013; Flickinger *et al.*, 2016). While these studies offer important insights into why boards vary in their responses to misconduct, we depart from agency-centered or situational explanations to argue that such decisions may be fundamentally shaped by directors' beliefs – how they perceive the misconduct and attribute blame – and what they view to be the correct course of action following misconduct. As a result, such decisions depend on subjective beliefs of directors. Although beliefs per se are not necessarily self-serving, they may lead to outcomes that counteract widely accepted norms that misconduct is categorically wrong and ought to be penalized, helping better explain why boards may not dismiss CEOs following financial misconduct.

To understand how a board's beliefs or assumptions may influence how they respond to organizational misconduct, we adopt a non-intrusive and well-established method to assess a board's beliefs, as represented by their political ideology. Political ideology is a set of beliefs that has been demonstrated to influence individuals' personal choice and decisions (Eastwick *et al.*, 2009), and thus, the actions of organizations (Briscoe, Chin, and Hambrick, 2014). Building on this literature, we examine how the political ideologies of board members influence firm actions following misconduct. Utilizing work on ideo-attribution and threat management, we investigate how boards that differ in their ideologies may perceive and react differently to threats presented by organizational misconduct – for instance, by viewing threats more seriously and

attributing them to either personal irresponsibility or external and situational issues, in turn leading to different actions.

We investigate these questions in the context of US S&P 1500 firms that were charged with financial misconduct and required by the Securities and Exchange Commission (SEC) to restate their earnings within the ten-year period from 2003 to 2012. Our results demonstrate that board ideology matters, with conservative board members more likely to dismiss the chief executive following financial misconduct. This paper contributes to the organizational misconduct and corporate governance literatures by demonstrating how boards' perceptions of who is responsible for misconduct and what the consequences should be may depend on individual beliefs, even in the wake of an event that is widely viewed as unacceptable. We also contribute to and extend work on the role of political ideology in organization by focusing on the effects of ideo-attribution and threat management.

## **THEORY AND HYPOTHESIS**

Financial misconduct has been commonly viewed as a quintessential example of leadership lapses that expose the questionable ethical standards of top managers in modern organizations (Pozner and Harris, 2016). As such, companies that have committed misconduct sometimes seek to repair their image by disassociating themselves from leaders seen as responsible for financial malfeasance (Devers *et al.*, 2009) hoping that the CEO's departure will signal to stakeholders that the firm takes the misconduct seriously and is earnest about reestablishing its reputation and legitimacy (Gomulya and Boeker, 2016). Studies have shown that firms forced to restate their earnings are more likely to dismiss their CEOs than are companies that did not restate (e.g., Desai *et al.*, 2006). However, the majority of firms, even those with severe financial misconduct, do not dismiss their CEOs (Beneish *et al.*, 2017).

## **Political Ideology**

Political ideology provides individuals a framework for understanding their social environment and their role within it (Denzau and North, 1994). Although some differences in political ideology are historically and culturally specific, the conventional spectrum of liberal-conservative has been identified as especially important for understanding individuals' beliefs and values and has been the single most useful and parsimonious way to classify political ideology for more than 200 years (Jost, 2006). In addition, the core dimensions of liberal and conservative ideologies have been shown to be universal, relatively stable, and enduring throughout an individual's lifetime, providing structure to their thinking and actions (Ashton *et al.*, 2005). To understand the form and function of political ideologies, political and social psychologists have examined their fundamental features, demonstrating that conservatism is associated with characteristics like a desire for order and stability, a preference for gradual rather than revolutionary change, and a greater deference to the current system and existing order (Carney *et al.*, 2008). In contrast, liberalism has been associated with a greater tolerance for different points of view and an openness to change and new experiences (Thórisdóttir and Jost, 2011).

Differences in political ideology have been shown to have an important influence on thinking and actions, not only in people's daily lives (Jost, Federico, and Napier, 2009), but also in the decisions of organizational leaders. Recent work has examined how the political ideologies of executives and top managers influence their managerial and governance decisions and actions (Chin, Hambrick, and Trevino, 2013; Christensen *et al.*, 2015; Gupta and Wowak, 2017). Extending this perspective to the arena of financial misconduct, we propose that political

ideologies may have an important influence on board members' key decisions and actions through two primary effects: ideo-attribution and threat management.

***Ideo-attribution.*** As psychologists have long noted (Skitka and Washburn, 2013), individuals vary in how they assess and attribute causality when observing the actions of others. The ideo-attribution effect argues that conservatives tend to explain a wide range of social issues and behaviors by referencing dispositional causes (i.e., those related to the individual's character) and emphasizing personal responsibility and effort. In contrast, liberals tend to attribute the same problems to external and situational causes (Bobbio, Canova, and Manganeli, 2010). For example, conservatives tend to blame criminal actions on the character of the criminal, whereas liberals on situational factors such as an underprivileged upbringing (Carroll *et al.*, 1987).

This ideo-attribution effect not only influences interpretations of the behavior of others, but also affects what actions – if any – individuals take to change or correct those behaviors. Based on their beliefs about the importance of personal responsibility in cases of both success and failure, conservatives tend to have a more punitive attitude toward norm violators (Jost *et al.*, 2009). Research has demonstrated that conservatives are more likely to feel morally offended by norm violators and advocate for harsher penalties for such violations (Altemeyer, 1988). Based on the ideo-attribution effect, we argue that boards having directors with more conservative political ideologies are more likely to attribute the firm's financial misconduct to the misconduct of managers, and discipline them with harsher penalties, such as dismissal.

***Threat management.*** Political psychology scholars have shown that political ideology can also influence how individuals perceive and deal with threat (Augoustinos, Walker, and Donaghue, 2014). Conservatives generally perceive the world as a more threatening and

dangerous place (Duckitt, 2001); are more sensitive to social, economic, and political threats (Doty, Peterson, and Winter, 1991; Willer, 2004); and tend to be more concerned about threats and loss than are liberals (Jost *et al.*, 2003). These perceptions and tendencies lead to a greater need to maintain safety, minimize danger, and manage threats (Jost, Nosek, and Gosling, 2008). Such perceptions encourage conservative individuals to embrace solutions that minimize threats, even though the solutions may be rather simplistic and rigid (Bonanno and Jost, 2006).

Financial misconduct poses a serious threat, not only because of its negative material effect on the firm (Scholz, 2013), but also because it can represent a personal threat to board members' own reputations and standing. Directors of firms that are forced to restate their earnings can be legally challenged as a result of their apparent ineffectiveness at monitoring managers (Brochet and Srinivasan, 2014), or face negative consequences in future employment due to their compromised reputation (Fama and Jensen, 1983). Based on how they typically react to threat, more conservative directors may perceive financial misconduct as posing an even greater occupational or personal hazard and may thus react more strongly.

Such differences in the perception of threat, along with ideo-attribution effects, lead us to predict that boards may perceive and react differently to cases of financial misconduct depending on their ideologies, attributing potential threats to either direct personal responsibility or external and situational causes. Consequently, more conservative boards are likely to react more strongly to the threat represented by the disclosure of financial misconduct and to assign blame to the CEO of the firm. As a result, more conservative boards are more likely to urge serious action, such as CEO dismissal, in reaction to financial misconduct.

*Hypothesis: There is a positive relationship between a board's political conservatism and the probability of CEO dismissal following financial misconduct.*



## METHODOLOGY

We test our theory and hypothesis by examining S&P 1500 firms from 2003 to 2012 that were involved with financial misconduct, specifically earnings misrepresentation, and required by the SEC to restate their earnings. We use data from the AuditAnalytic database, which lists firms that revised their earnings as a result of aggressive accounting practices and/or non-compliance to or misinterpretation of accounting rules. Since we focus on financial misconduct, we included firms that committed a material misrepresentation, excluding firms that had simple clerical errors that may not be material to the prior financial statement (Hennes, Leone, and Miller, 2008), and firms with restatement that resulted in positive changes in their earnings. We observed that some CEOs who committed misrepresentation left before the firms were forced to restate their earnings. We dropped these cases from the sample since the firms had new CEOs who were not responsible for the misrepresentation when they restated their earnings. This left us with 276 firms in our sample.

***Dependent variable.*** The dependent variable is a dummy variable that indicates *CEO dismissal* using ExecuComp database. To accurately measure CEO dismissal, we first collected all the cases of CEO replacement after a misrepresentation announcement. Following past work on financial misconduct, we focused on a two year window after the announcement to minimize other confounding influences (e.g., Desai *et al.*, 2006). Among these CEO replacements, we identified cases of CEO dismissal using criteria employed in previous studies (e.g., Finkelstein, Hambrick, and Cannella, 2009; Hubbard, Christensen, and Graffin, 2017), specifically: 1) CEOs were fired or forced out; 2) CEOs stepped down for undisclosed personal reasons or resigned to pursue other interests; and 3) CEOs retired before reaching age 65 and also gave up their board seat/advisory or consulting role. We coded these cases as CEO dismissal equal to 1, and 0

otherwise. We further verified the accuracy of this variable using SEC documents, press releases, and news articles.

***Independent variable.*** We measured political ideology based on individual political campaign donation information collected from the Federal Election Commission (FEC), which has been used in different disciplines including sociology, political science, finance and management (Bonica, 2013; Burris, 2001; Christensen *et al.*, 2015; Lee, Lee, and Nagarajan, 2014). Lee and his colleagues (2014) suggest that political donations reflect individuals' political beliefs rather than their attempts to act opportunistically or in their own economic interests. Christensen and his colleagues (2015) demonstrate that political donations are a valid measure of political orientation after comparing donation patterns to the self-reported political alignments of CEOs. Accordingly, measuring political ideology on the basis of political donations has been shown to be a consistent measure for capturing one's personal political ideology (Bonica, 2013).

To measure board ideology, we first collected political donations made by each director to political campaigns (i.e., to candidate or party) between the years of 1979 to 2014 from the FEC (the FEC began publishing donation data from 1979). Following past studies, we measured a director's political orientation by calculating the net donation made to the Republican Party (equal to the total amount donated to the Republican Party minus that donated to the Democratic Party, divided by total amount donated to both parties) (Christensen *et al.*, 2015; Lee *et al.*, 2014). The resulting values for individual political orientation range from  $-1$  to  $+1$ , where  $-1$  indicates that all donations were made to the Democratic Party while  $+1$  indicates that all donations were made to the Republican Party.

To further assess the face validity of our measure, we examined whether political donation patterns also matched individuals' political party affiliations and voting behaviors

following a study by Levendusky (2009), which found that conservatives have overwhelmingly identified with Republicans and liberals with Democrats since the 1970s. To the extent that political donation patterns correlate with actual political party affiliations or voter registrations, the use of donation information represents a more valid measure of political ideology. We researched all 2,434 directors in our sample and manually collected political party affiliation and voter registration information data using multiple sources such as state voter registration websites, political campaign reports, news articles and press release, personal blogs, and other websites. Note that the information we collected here excludes the campaign donation information itself, which we try to validate. While it was extremely difficult to gather information on their political affiliations or voting behavior, we were able to gather such information for 13.4% of the directors (i.e., 326 directors). For those directors where information was available we ran a correlation analysis between our measure (i.e. political campaign donation) and the newly collected political affiliation data (1 for having affiliation with Republican Party or registered as Republican, 0 for having affiliation with Democratic Party or registered as Democrat). We found that these two are highly and significantly correlated (0.802,  $p < 0.01$ ), offering convergent validity to our measure of political donations.

Similar to past work (Christensen *et al.*, 2015), we created a weighted measure for board ideology since the influence and responsibility of each person is dependent on the position they hold. We considered two director positions that are particularly relevant in misrepresentation events: the chair of the board and the chair of the audit committee, since they have been viewed as more accountable for firm financial misconduct (Srinivasan, 2005). The resulting independent variable, *Board conservatism*, is a weighted summation of individual ideology values, where the chairperson of the board gets assigned a weight of 1, the audit committee chair 0.5, and other

directors 0.3 following Christensen et al., (2015). For a robustness check, we also assigned uniform weights to all positions and obtained the same conclusion (see Online Appendix Table 4). In addition, following past research on financial misconduct (e.g., Desai *et al.*, 2006; Gomulya and Boeker, 2016), we collected this variable at the misrepresentation announcement since boards tend to initiate an investigation immediately following the announcement (Hansell and Brown, 2003).

***Control variables.*** We included a number of control variables known to influence the dependent variable in our models. These variables were collected at the time of the misrepresentation announcement following past work (e.g., Desai *et al.*, 2006; Gomulya and Boeker, 2016). For firm characteristics, we included *Total assets* as firm size, performance measures such as return on assets (*ROA*), and sales growth (*Annual growth*) (Arthaud-Day *et al.*, 2006). For the governance structure of the firm, we controlled for the board size (i.e., *Number of directors*), proportion of independent directors on the board (*% of independent director*), proportion of CEO appointed directors (*% of CEO appointed director*), and *CEO duality* (Finkelstein *et al.*, 2009; Gomulya and Boeker, 2016). For CEO characteristics we controlled for *CEO tenure*, and *CEO age* (Desai *et al.*, 2006), *Founder CEO* (Boeker, 1992), and *CEO conservatism* using the same method used for director's ideology mentioned above.

In addition, we included *Celebrity CEO* based on high-profile awards given to CEOs prior to the misconduct incidents from Business Week's Top Managers of the Year and National Ernst & Young Entrepreneur of the year (Koh, 2011). We included the magnitude of restated income (*Amount of restating income*). Restated income is the amount of income that is corrected. For example, if company A restated their income from \$100 million to \$70 million, the restated income is \$30 million. This variable was log transformed to account for skewedness.

We also included the reaction of the stock market – the market-adjusted cumulative abnormal return (*CAR*) from three days prior to three days after the restatement announcement date since the reaction of the stock market can influence CEO dismissal decisions (Wright, Kroll, and Elenkov, 2002). Because media can also play a significant role in our model (Wiersema and Zhang, 2013), we captured and controlled for *Media attention* based on the number of news articles that focused on the misrepresentation. We collected both national and regional news articles about the sample firms from the Lexis-Nexis database three months before and three months after the restatement announcement and carefully read each article in order to exclude ones that were irrelevant to the misrepresentation incidents. We then counted the number of news articles that covered the firm’s financial misrepresentation to create *Media attention*. Industry and restating year were also controlled for in our models.

***Estimation model.*** Firms that misrepresent their earnings may be substantially different from firms that do not and such a selection bias may affect our estimation for CEO dismissal. To address this sample-induced endogeneity, we used a two-stage Heckman model with a matched pair sample approach (Certo *et al.*, 2016; Heckman, 1979) that has been frequently employed in past studies of financial misconduct (Arthaud-Day *et al.*, 2006; Desai *et al.*, 2006). Indeed, we do find that there is a sample-induced endogeneity, and adopting Heckman model to control for it is appropriate based on the significance of our main independent variable (i.e., board conservatism) in the first stage (Certo *et al.*, 2016). We include the details of the method and results of the first stage in Online Appendix Table 1. This procedure left us with a final sample of 276 firms for the main models. The inverse Mills ratio from the first-stage probit model was controlled for in the second-stage CEO dismissal models, where we used logistic regression with robust estimator of variance across the models to address potential misspecifications in the models (Huber, 1967).

## RESULTS

We summarize the descriptive statistics in Table 1. % of *CEO appointed directors* and *CEO tenure* variables are shown to be correlated, but the Variance Inflation Factors (VIFs) were shown to be very low, ranging from 1.05 to 2.99 with mean VIF of 1.48, thus limiting multicollinearity concerns. Model 1 of Table 2 includes the control variables. The control variables that are consistently significant across the models are *ROA*, *amount of restating income*, *stock market reaction (CAR)*, and *Media attention*.

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Insert Table 1 – 2 and Figure 1 about here  
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Our hypothesis predicts that board conservatism is significantly and positively associated with CEO dismissal. In Model 2 of Table 2 we find support for this hypothesis ( $\beta=0.486$ ,  $p=0.03$ ). Figure 1 shows that conservative boards are almost three times more likely than liberal boards to dismiss restating CEOs, with a probability of 0.06 for liberal boards (1 S.D. below the mean) as compared to 0.17 for conservative boards (1 S.D. above the mean). Boards with a more conservative ideology demonstrate a probability of dismissing their CEOs that is more than 50% greater than boards with a moderate political ideology (0.17 vs. 0.11).

**Robustness checks.** To test the robustness of our findings, we conducted a number of additional analyses, including using event history analyses rather than logistic regression and employing different operationalizations of our key variables (e.g., using lagged independent variables and using a simple summation for board conservatism). These robustness checks confirm our conclusions, offering further confidence in our findings. In addition, we included supplementary analyses that complement our theory using an industry-level norm around financial misconduct. These additional analyses are available in the Online Appendix.

## **DISCUSSION AND CONCLUSION**

Financial misconduct poses a significant material and reputational threat to organizations, destroying billions of dollars in shareholder value. While the public, the media, and policy makers have demonstrated heightened interest in this issue, we know very little about whether and how the board's reaction to financial misconduct may be influenced by their perceptions, personal preferences, and beliefs. This study investigates the political ideologies of board members and how these ideologies reflect underlying beliefs that influence boards' perceptions and reactions to threats posed by misconduct.

Our findings support the perspective that boards may perceive and react differently to misconduct depending on their ideologies, attributing the source of those threats more directly to either personal responsibility or external and situational causes. Because of these differences, boards with a more conservative political ideology are likely to react more strongly to the threat represented by the disclosure of financial misconduct and to attribute blame to the leader of the firm. As a result, more conservative board members are more likely to take serious action, such as CEO dismissal, in reaction to financial misconduct.

### **Contributions**

By examining board responses to organizational misconduct, this study extends our understanding of differences across groups of individuals and demonstrates the way in which political ideology can have an important influence on how proactive a board is in dismissing the CEO following financial misconduct. Previous studies suggest that the structure of the board (e.g., relationship between CEO and board members) and situational factors such as media attention may influence the outcomes of financial misconduct (e.g., Gomulya and Boeker, 2016; Wiersema and Zhang, 2013). This research advances beyond these studies. Although members of

the board of directors are not expected to bring their personal beliefs or ideologies into decisions as critical as CEO dismissal, we demonstrate how these beliefs have, in fact, an important influence on the firm's actions following an event that threatens the legitimacy of the firm and thus raises questions regarding the efficacy of the board's oversight and monitoring. By employing threat management and ideo-attribution mechanisms, we demonstrate how differences in ideology may shape the perceptions of actors and lead to different sets of actions by managers.

Our paper demonstrates how the beliefs of directors have a critical influence on organizational-level decisions such as CEO dismissal, reinforcing a central concept of Hambrick and Mason's (1984) theoretical perspective. In addition, this is the first study we are aware of that looks at the impact of the political ideology of the board on the outcome of CEO dismissal, which can prompt significant organizational changes. As such, this study complements and extends an emerging body of literature that examines political ideology in organizations (Chin *et al.*, 2013; Christensen *et al.*, 2015; Gupta, Briscoe, and Hambrick, 2017) by incorporating important, but often overlooked aspects (i.e., ideo-attribution and threat management) of political ideology that help us further understand organization-level behaviors and outcomes.

### **Limitations and Future Research**

A clear limitation of this work is its generalizability to institutional environments outside of the United States. Although the core aspects of liberal-conservative belief systems are shown to be remarkably similar across the world (Ashton *et al.*, 2005; Duckitt, 2001), in other parts of the world different governance and policy structures may moderate the power dynamics between the CEO and the board. Nevertheless, we believe that fundamental tenets of political ideology – such as attribution tendencies and threat management – likely play important roles in the boards of other countries as well.



We believe there are several interesting and significant opportunities for future studies to build on this work. First, we acknowledge that despite the widespread adoption and a recent validation of our political ideology measure (Lee *et al.*, 2014) as well as our independent validation efforts, it is hard to find an ideal measure of a subjective belief such as political ideology using archival data. We see this limitation as an area for potential methodological advancement in the future if better information about individuals' political preferences can be validated through larger-scale data initiatives, including textual analyses of statements from individuals and machine learning. In addition, ideologies can encompass a much wider and more diverse range of beliefs and values than conservatism or liberalism, such as from Marxism to fascism, as well as more focused ideologies such as feminism and environmentalism. Although the liberal-conservative spectrum has been viewed as the single most useful and parsimonious way to classify political ideology for more than 200 years and across the world (Jost, 2006), future research should explore the influence of more nuanced and contextualized ideologies on organizations. Another compelling future opportunity concerns the degree of uniformity or variance in ideologies and beliefs across members of a single board, and how this may influence CEO dismissal following financial misconduct. We employ an overall measure of conservatism or liberalism to characterize the board, but boards also vary in how homogeneous their members' beliefs are, and this variance may play an important role in their actions.

The results of this study augment past research that has shown chief executive dismissal to be a political process by drawing attention to how the beliefs and ideological positions of board members influence responses to reputation-damaging events. We hope this study spurs future research to better understand the interaction between beliefs and actions taken by key decision makers.

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Table 1. Descriptive statistics and correlations

	Mean	S.D.	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
(1) CEO dismissal	0.22	0.41																
(2) Total assets	21004.65	161918.29	0.00															
(3) ROA	1.92	9.97	-0.03	-0.01														
(4) Annual growth	-0.45	6.20	-0.08	0.01	0.13													
(5) Number of directors	8.82	2.19	0.06	0.19	0.03	-0.03												
(6) % of Independent directors	0.75	0.13	0.04	0.05	-0.08	-0.15	0.11											
(7) % of CEO appointed directors	0.52	0.28	-0.12	-0.04	0.10	0.17	-0.13	-0.12										
(8) Founder CEO	0.03	0.17	-0.04	-0.02	0.03	-0.03	-0.09	-0.04	0.05									
(9) CEO duality	0.70	0.46	0.06	0.07	0.10	0.08	0.11	-0.18	0.26	-0.03								
(10) CEO tenure	10.22	7.45	-0.10	-0.06	0.12	0.12	-0.10	-0.18	0.70	0.07	0.22							
(11) CEO age	56.92	7.01	-0.07	-0.03	0.09	0.08	0.09	-0.14	0.18	-0.01	0.17	0.39						
(12) Celebrity CEO	0.05	0.22	0.04	-0.03	0.04	0.01	-0.06	0.04	0.21	0.06	0.04	0.13	-0.10					
(13) CEO conservatism	0.14	0.65	-0.02	-0.07	0.11	0.03	0.06	-0.01	0.03	0.05	0.02	0.04	0.09	-0.14				
(14) Amount of restating income (log)	15.93	1.74	0.17	0.28	0.04	-0.02	0.22	0.06	0.06	0.01	0.08	0.08	-0.02	-0.05	-0.01			
(15) CAR	-0.02	0.11	-0.14	0.01	0.07	-0.06	0.00	-0.01	0.02	0.01	-0.03	0.15	0.03	0.07	-0.14			
(16) Media attention	0.85	5.02	0.17	0.42	0.02	0.00	0.18	-0.03	0.00	-0.02	0.06	-0.02	-0.01	-0.01	-0.09	0.35	-0.03	
(17) Board conservatism	0.26	1.05	0.07	-0.06	0.09	0.04	0.11	-0.01	-0.11	0.10	0.00	-0.05	0.09	-0.12	0.47	-0.03	0.07	-0.09

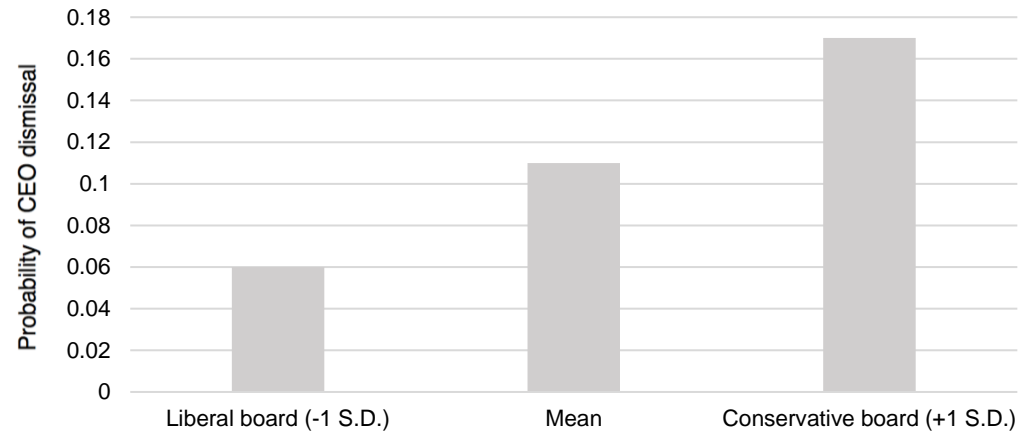


Figure 1. Probability of CEO dismissal depending on board ideology

Table 2. CEO dismissal model

	(1)	(2)
Total assets	-0.000 (0.000) [0.14]	-0.000 (0.000) [0.07]
ROA	-0.033 (0.017) [0.05]	-0.033 (0.017) [0.05]
Annual growth	-0.027 (0.037) [0.46]	-0.028 (0.038) [0.46]
Number of directors	0.060 (0.107) [0.57]	0.052 (0.110) [0.64]
% of Independent directors	3.222 (1.862) [0.08]	2.804 (1.868) [0.13]
% of CEO appointed directors	-1.183 (1.042) [0.26]	-1.259 (1.086) [0.25]
Founder CEO	-1.251 (0.908) [0.17]	-1.931 (0.909) [0.03]
CEO duality	0.222 (0.470) [0.64]	0.247 (0.490) [0.61]
CEO tenure	0.019 (0.051) [0.72]	0.013 (0.052) [0.80]
CEO age	0.002 (0.030) [0.94]	-0.005 (0.031) [0.88]
Celebrity CEO	0.920 (0.930) [0.32]	0.970 (0.965) [0.31]
CEO conservatism	-0.064 (0.290) [0.82]	-0.344 (0.337) [0.31]
Amount of restating income (log)	0.230 (0.132) [0.08]	0.234 (0.134) [0.08]
CAR	-2.778 (1.243) [0.03]	-2.760 (1.272) [0.03]
Media attention	0.216 (0.084) [0.01]	0.209 (0.069) [0.00]
Lambda	1.075 (1.031) [0.30]	0.274 (1.060) [0.80]
Board conservatism		0.486 (0.222) [0.03]
Industry and year controlled	Yes	Yes
Constant	-6.687 (3.610) [0.06]	-5.146 (3.650) [0.16]
N	276	276
Log-likelihood	-105.97	-103.85
$\chi^2$	91.51	95.08
Pseudo R-squared	0.27	0.28

Standard error in parentheses and *p*-value in bracket

## ONLINE APPENDIX

Table 1. First stage models on financial restatement

	(1)	(2)
Net income $t-1$	0.000 (0.000) [0.42]	0.000 (0.000) [0.42]
ROA difference $t-1$	0.006 (0.009) [0.50]	0.006 (0.009) [0.50]
ROA compare to industry ROA $t-1$	-0.015 (0.007) [0.03]	-0.015 (0.007) [0.03]
Number of directors $t-1$	-0.001 (0.029) [0.97]	-0.004 (0.029) [0.90]
% of independent director $t-1$	1.507 (0.458) [0.00]	1.612 (0.461) [0.00]
Avg. director tenure $t-1$	-0.038 (0.018) [0.04]	-0.041 (0.018) [0.02]
CEO duality $t-1$	0.056 (0.009) [0.00]	0.056 (0.009) [0.00]
CEO tenure $t-1$	-0.077 (0.136) [0.57]	-0.082 (0.136) [0.55]
Bonus/total compensation $t-1$	0.161 (0.267) [0.55]	0.137 (0.268) [0.61]
Board conservatism	-0.111 (0.053) [0.04]	-0.105 (0.054) [0.05]
Stock option/total compensation $t-1$		-0.698 (0.293) [0.02]
Industry and year controlled	Yes	Yes
Constant	-0.932 (0.741) [0.21]	-0.715 (0.749) [0.34]
N	552	552
Log-likelihood	-350.68	-347.80
$\chi^2$	63.88	69.63

Standard error in parentheses and  $p$ -value in bracket

Firms that misrepresented their earnings may be substantially different from firms that do not and such selection bias may affect our estimation for CEO dismissal. To address this sample-induced endogeneity, we used a two-stage Heckman model with a matched pair sample approach (Certo *et al.*, 2016; Heckman, 1979) that has been frequently employed in past studies of financial misconduct (Arthaud-Day *et al.*, 2006; Desai *et al.*, 2006). Following previous studies, we matched each restating firm with an S&P 1500 firm based on (1) four-digit SIC code, (2) similarity in size and total assets, and (3) year of restatement. Through this procedure we identified 276 non-misrepresented matching firms for our initial sample, giving us a total of 552 firms.

In the first stage of the Heckman model, the dependent variable is a binary variable (misrepresentation or not). For an instrumental variable, we used the proportion of CEO pay from stock options since it has been shown to influence the probability of financial misconduct (Burns and Kedia, 2006; Efendi, Srivastava, and Swanson, 2007; Harris and Bromiley, 2007) while not having a direct impact on CEO dismissal. We measured this variable by calculating the total stock option grant value using the Black-Scholes model divided by total compensation (Sanders and Hambrick, 2007; Wowak, Mannor, and Wowak, 2015). We included the independent variable in the first stage to see whether sample selection bias exists (Certo *et al.*, 2016). In addition, we added several control variables that have shown to influence the occurrence of financial restatement. Following the previous studies, we included *net income* $_{t-1}$ , historical performance using *ROA difference*  $_{(t-1-t-2)}$ , *ROA compare to industry average ROA*  $_{t-1}$ , *number of directors*  $_{t-1}$ , *% of independent director*  $_{t-1}$ , *Avg. director tenure*  $_{t-1}$ , *CEO duality* $_{t-1}$ , *CEO tenure* $_{t-1}$  *proportion of bonus in total compensation* $_{t-1}$ , *year* and *industry* using 2-digit SIC code (Burns and Kedia, 2006; Efendi *et al.*, 2007;

Harris and Bromiley, 2007). In line with the previous findings based on agency theory, we find in Appendix Table 1 that the proportion of stock options decreased the firm's engagement in financial misconduct ( $\beta=-0.698, p=0.02$ ) indicating its effectiveness as an instrumental variable. We also see that the independent variable is significant in the first-stage model, indicating that sample selection bias exists and our use of Heckman model is appropriate to address the bias. With this result, we estimated a predicted value and calculate the inverse Mills ratio (Lambda). The inverse Mills ratio is controlled for in the CEO dismissal models, which are the second stage models in Table 2.



Appendix Table 2. Robustness check models with event history analysis

	(1)	(2)
Total assets	-0.000 (0.000) [0.37]	-0.000 (0.000) [0.37]
ROA	-0.040 (0.016) [0.01]	-0.040 (0.016) [0.01]
Annual growth	-0.011 (0.017) [0.51]	-0.013 (0.017) [0.46]
Number of directors	0.021 (0.082) [0.79]	0.012 (0.081) [0.88]
% of Independent directors	3.191 (1.706) [0.06]	2.694 (1.714) [0.12]
% of CEO appointed directors	-1.019 (0.832) [0.22]	-1.099 (0.866) [0.20]
Founder CEO	-1.041 (1.124) [0.35]	-1.709 (1.224) [0.16]
CEO duality	0.196 (0.418) [0.64]	0.249 (0.427) [0.56]
CEO tenure	0.029 (0.042) [0.48]	0.020 (0.041) [0.62]
CEO age	0.005 (0.027) [0.85]	0.005 (0.027) [0.85]
Celebrity CEO	0.694 (0.706) [0.33]	0.771 (0.717) [0.28]
CEO conservatism	-0.170 (0.253) [0.50]	-0.433 (0.282) [0.13]
Amount of restating income (log)	0.258 (0.115) [0.02]	0.239 (0.117) [0.04]
CAR	-2.690 (1.202) [0.03]	-2.786 (1.112) [0.01]
Media attention	0.133 (0.046) [0.00]	0.134 (0.043) [0.00]
Lambda	1.296 (0.919) [0.16]	0.534 (0.962) [0.58]
Board conservatism		0.453 (0.197) [0.02]
Industry and year controlled	Yes	Yes
N	276	276
Log-likelihood	-286.55	-283.77
$\chi^2$	82.91	88.48

Standard error in parentheses and *p*-value in bracket

In our main analysis, we had used a binary outcome similar to previous studies that examine CEO dismissal (Desai *et al.*, 2006). Instead of using a binary dependent variable, we used the number of days to dismiss the CEO after the announcement as the dependent variable and used Cox proportional-hazards regression (Cox, 2018) to test whether our findings hold. In Appendix Table 2, we show the results from this approach, which yielded consistent results.

Appendix Table 3. Robustness check models with lagged independent variable

	(1)	(2)
Total assets	-0.000 (0.000) [0.14]	-0.000 (0.000) [0.07]
ROA	-0.033 (0.017) [0.05]	-0.033 (0.017) [0.05]
Annual growth	-0.027 (0.037) [0.46]	-0.028 (0.038) [0.47]
Number of directors	0.060 (0.107) [0.57]	0.051 (0.110) [0.64]
% of Independent directors	3.222 (1.862) [0.08]	2.770 (1.871) [0.14]
% of CEO appointed directors	-1.183 (1.042) [0.26]	-1.264 (1.086) [0.24]
Founder CEO	-1.251 (0.908) [0.17]	-1.875 (0.906) [0.04]
CEO duality	0.222 (0.470) [0.64]	0.258 (0.491) [0.60]
CEO tenure	0.019 (0.051) [0.72]	0.012 (0.052) [0.82]
CEO age	0.002 (0.030) [0.94]	-0.005 (0.031) [0.88]
Celebrity CEO	0.920 (0.930) [0.32]	0.985 (0.969) [0.31]
CEO conservatism	-0.064 (0.290) [0.82]	-0.355 (0.339) [0.29]
Amount of restating income (log)	0.230 (0.132) [0.08]	0.236 (0.134) [0.08]
CAR	-2.778 (1.243) [0.03]	-2.708 (1.260) [0.03]
Media attention	0.216 (0.084) [0.01]	0.210 (0.070) [0.00]
Lambda	1.075 (1.031) [0.30]	0.260 (1.060) [0.81]
Board conservatism		0.490 (0.224) [0.03]
Industry and year controlled	Yes	Yes
Constant	-6.687 (3.610) [0.06]	-5.120 (3.651) [0.16]
N	276	276
Log-likelihood	-105.97	-103.83
$\chi^2$	91.51	94.85
Pseudo R-squared	0.27	0.28

Standard error in parentheses and *p*-value in bracket

Since the dependent variable has a 2-year window from when the financial misconduct is announced, the board (and its ideology) may change over this two-year period. In cases where the CEO was dismissed one year after the restatement announcement, we lagged and updated the board's ideology based on the board configuration at the time of dismissal to match the year of the CEO dismissal. For example, if a financial misrepresentation was announced in

2010 and the CEO was dismissed in 2011, we updated the board's ideology variable to reflect it for 2011 and not for 2010. Our earlier conclusions continue to be supported.

Appendix Table 4. Robustness check models with simple summation for board conservatism

	(1)	(2)
Total assets	-0.000 (0.000) [0.14]	-0.000 (0.000) [0.07]
ROA	-0.033 (0.017) [0.05]	-0.033 (0.017) [0.05]
Annual growth	-0.027 (0.037) [0.46]	-0.028 (0.038) [0.47]
Number of directors	0.060 (0.107) [0.57]	0.051 (0.110) [0.64]
% of Independent directors	3.222 (1.862) [0.08]	2.770 (1.871) [0.14]
% of CEO appointed directors	-1.183 (1.042) [0.26]	-1.264 (1.086) [0.24]
Founder CEO	-1.251 (0.908) [0.17]	-1.875 (0.906) [0.04]
CEO duality	0.222 (0.470) [0.64]	0.258 (0.491) [0.60]
CEO tenure	0.019 (0.051) [0.72]	0.012 (0.052) [0.82]
CEO age	0.002 (0.030) [0.94]	-0.005 (0.031) [0.88]
Celebrity CEO	0.920 (0.930) [0.32]	0.985 (0.969) [0.31]
CEO conservatism	-0.064 (0.290) [0.82]	-0.355 (0.339) [0.29]
Amount of restating income (log)	0.230 (0.132) [0.08]	0.236 (0.134) [0.08]
CAR	-2.778 (1.243) [0.03]	-2.708 (1.260) [0.03]
Media attention	0.216 (0.084) [0.01]	0.210 (0.070) [0.00]
Lambda	1.075 (1.031) [0.30]	0.260 (1.060) [0.81]
Board conservatism		0.490 (0.224) [0.03]
Industry and year controlled	Yes	Yes
Constant	-6.687 (3.610) [0.06]	-5.120 (3.651) [0.16]
N	276	276
Log-likelihood	-105.97	-103.83
$\chi^2$	91.51	94.85
Pseudo R-squared	0.27	0.28

Standard error in parentheses and *p*-value in bracket

We also created a simple summation of individual director's ideologies for the board ideology measure as compared to the earlier weighted summation. Appendix Table 4 summarizes the findings using this simple summation variable. We continue to find support for hypothesis.

Appendix Table 5. Supplementary analysis with industry-level financial misconduct precedents

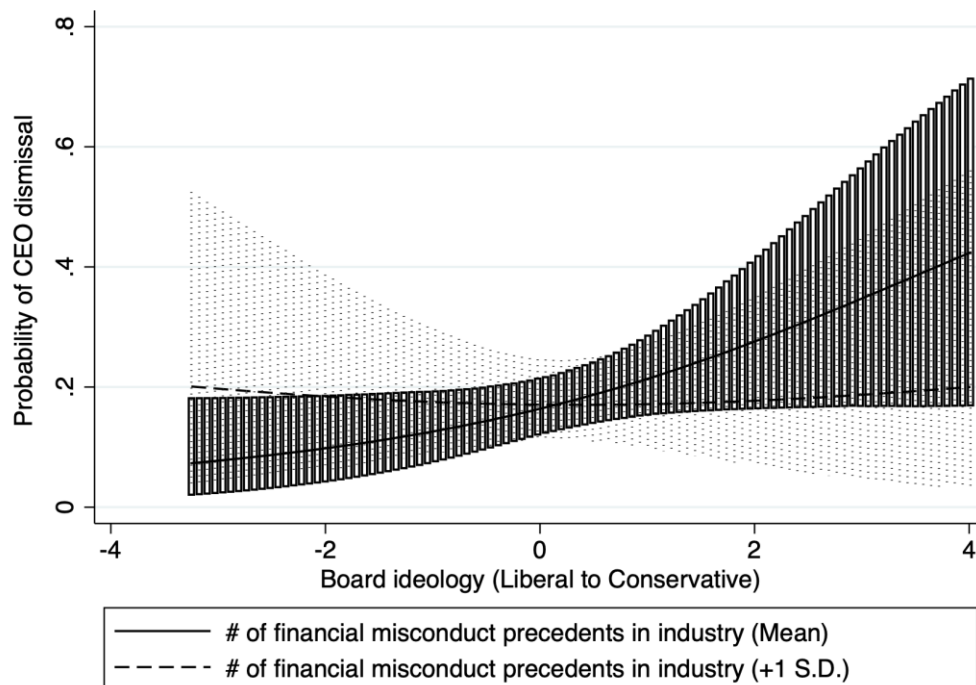
	(1)	(2)
Total assets	-0.000 (0.000) [0.11]	-0.000 (0.000) [0.16]
ROA	-0.031 (0.018) [0.07]	-0.036 (0.018) [0.05]
Annual growth	-0.033 (0.036) [0.36]	-0.032 (0.040) [0.43]
Number of directors	0.027 (0.103) [0.80]	0.008 (0.106) [0.94]
% of Independent directors	3.318 (1.943) [0.09]	3.444 (1.973) [0.08]
% of CEO appointed directors	-1.085 (1.129) [0.34]	-1.228 (1.159) [0.29]
Founder CEO	-2.315 (0.990) [0.02]	-2.772 (1.025) [0.01]
CEO duality	0.223 (0.488) [0.65]	0.368 (0.511) [0.47]
CEO tenure	0.024 (0.058) [0.68]	0.037 (0.059) [0.53]
CEO age	-0.011 (0.032) [0.73]	-0.014 (0.032) [0.66]
Celebrity CEO	0.928 (0.964) [0.34]	1.046 (1.106) [0.34]
CEO conservatism	-0.295 (0.341) [0.39]	-0.196 (0.351) [0.58]
Amount of restating income (log)	0.256 (0.136) [0.06]	0.264 (0.139) [0.06]
CAR	-2.687 (1.250) [0.03]	-3.125 (1.327) [0.02]
Media attention	0.206 (0.078) [0.01]	0.220 (0.091) [0.02]
Lambda	0.548 (1.110) [0.62]	0.558 (1.139) [0.62]
Board conservatism	0.479 (0.225) [0.03]	0.846 (0.259) [0.00]
Number of financial misconduct precedents in industry	-0.156 (0.105) [0.14]	-0.126 (0.116) [0.28]
Board conservatism × Number of financial misconduct precedents in industry		-0.167 (0.069) [0.02]
Industry and year controlled	Yes	Yes
Constant	-5.334 (3.672) [0.15]	-5.719 (3.764) [0.13]
N	276	276

Log-likelihood	-102.44	-99.46
$\chi^2$	98.62	93.72
Pseudo R-squared	0.29	0.31

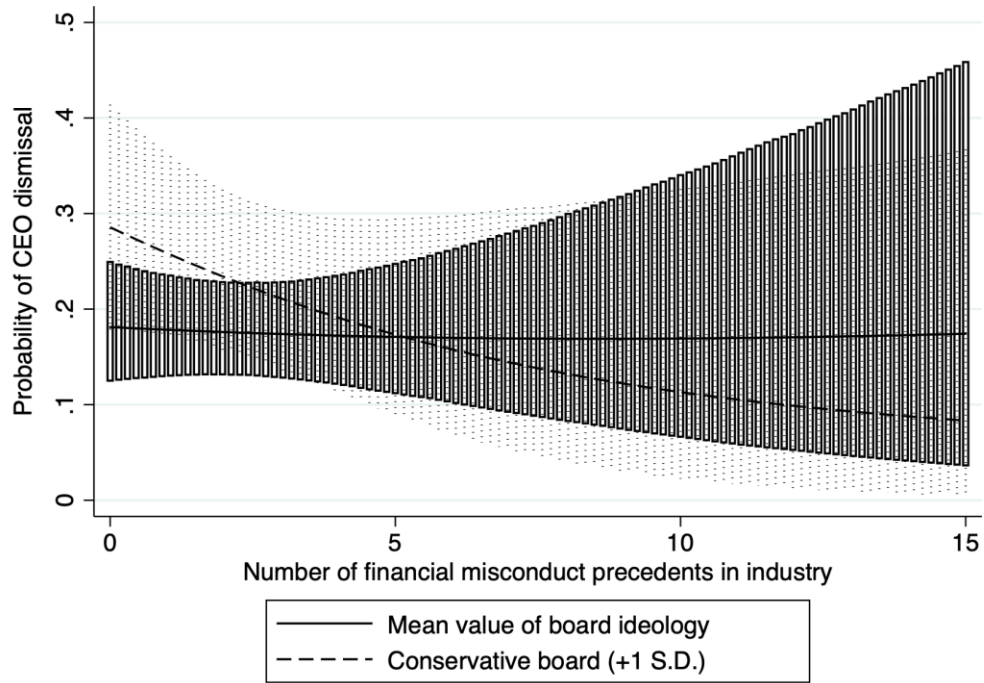
Standard error in parentheses and *p*-value in bracket

We conducted supplementary analyses that may be related to the hypothesis. Based on our theory, we speculate that board ideology would be influenced by industry norms. If other firms in the same industry have previously committed financial misconduct, it may reduce the salience of the focal misconduct. Hence, conservative boards may not view their misconduct as threatening than when they are the only company in the industry to commit financial misconduct. Similarly, if financial misconduct is pervasive in the industry, conservative boards may not be able to as readily attribute the firm’s misconduct to the CEO since misconduct may reflect systematic issues in that industry. For these reasons, we suggest that the number of financial misconduct precedents in the industry would mitigate the relationship between a board’s political conservatism and the probability of CEO dismissal following financial misconduct.

To examine this possibility, we searched the number of instances of serious and material financial misconduct (i.e., material misrepresentation with negative changes in earnings) occurring in the industry based on the 4-digit SIC code for the past five years prior to focal company’ misrepresentation. We see in Appendix Table 5 that the interaction effect is significant ( $\beta=-0.167, p=0.02$  in Model 2). We tabulated the results in Appendix Figure 1 and 2. Figure 1 and 2 come from the same analyses except that their x-axis variables and moderators are switched to provide alternative ways of examining the results. In Appendix Figure 1, we find that if the number of financial misconduct precedents in the industry is at the mean, there is a noticeable slope from liberal boards to conservative boards. On the other hand, if the number of financial misconduct precedents in the industry is 1 standard deviation above, the probabilities of CEO dismissal between liberal boards and conservative boards seem not to be different significantly. Similarly, as Figure 2 illustrate, when the board is conservative and the industry has more prior misrepresentation, the probability of CEO dismissal is much lower than when there was no prior incident. Hence we find support for our speculation and these results supplement our main theory and hypothesis.



Appendix Figure 1. Moderating effect of number of financial misconduct precedents in industry on board ideology.



Appendix Figure 2. Moderating effect of board ideology on the effect of number of financial misconduct precedents in industry.