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Whistle-Blowing: Target Firm Characteristics and Economic Consequences

Robert M. Bowen; Andrew C. Call; Shiva Rajgopal

+ Author & Article Information

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ABSTRACT: We document the first systematic evidence on the characteristics and economic consequences of firms subject to employee allegations of corporate financial misdeeds. First, compared to a control group that avoided public whistle-blowing allegations, firms subject to whistle-blowing allegations were characterized by unique firm-specific factors that led employees to expose alleged financial misdeeds. Second, on average, whistle-blowing announcements were associated with a negative 2.8 percent market-adjusted five-day stock price reaction; this reaction was especially negative for allegations involving earnings management (−7.3 percent). Third, compared to a control group that exhibits similar characteristics, firms subject to whistle-blowing allegations were associated with further negative consequences including earnings restatements, shareholder lawsuits, and negative future operating and stock return performance. Finally, whistle-blowing targets exposed by the press were more likely to make subsequent improvements in corporate governance. Our results suggest whistle-blowing is far from a trivial nuisance for targeted firms, and on average, appears to be a useful mechanism for uncovering agency issues.

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