

Offshore and Onboard: Secret Offshore Companies and Director Career Outcomes

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Joint work with
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- How are directors valued who behave in unethical ways?
- Unethical behavior of firm
 - ▶ Accounting irregularities (Arthaud-Day et al., 2006; Hazarika et al., 2012; Leone and Liu, 2010)
 - ▶ Socially irresponsible actions (Chiu and Sharfman, 2018)
 - ▶ Stock option backdating (Bizjak, Lemmon, Whitby, 2009)
 - ▶ No evidence on outside directors' unethical behavior.
- What we need
 - ▶ a measure of unethical behavior on director level
 - ▶ an exogenous shock to unethical behavior or an information release related to unethical behavior



An ICIJ Investigation

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f t in e

The banner features a dark, atmospheric cityscape at night with a lightning bolt striking a skyscraper. In the foreground, the backs of a man and a woman are visible as they look at a glowing red box filled with papers. A large silver coin with the Pandora Papers logo and the year 2021 is centered in the upper half. Social media icons for Facebook, Twitter, LinkedIn, and Email are positioned below the main text.

- Pandora, Paradise, and Panama papers contain information on individuals who have secret offshore companies (SOCs) and serve on boards of US firms.

- Literature using ICIJ leaks
 - ▶ Network structure of tax evasion (Fernando and Antoine 2022)
 - ▶ Quality of financial reporting (Schmal et al., 2021)
 - ▶ SOC ownership of firms (O'Donovan et al., 2019)
 - ▶ No other published paper/nothing related to directors
- Board of directors in the US
 - ▶ governs the cooperation, determines strategy, appoints Chief Executive Officer, . . .
 - ▶ inside directors manage the firm, while outside directors monitor and advise the management.
- Research question
 - ▶ How do these leaks affect the career path of SOC-affiliated outside directors (SOCADs)?
 - ▶ Are firms affected?

Information on SOCADs

- Leaks
 - ▶ Pandora papers (Oct 2, 2021); Paradise papers (Nov 5, 2017); Bahamas leaks (Sep 21, 2016); Panama papers (April 3, 2016), Offshore leaks (June 14, 2013)
 - ▶ First, middle and last names
- Matching
 - ▶ BoardEx: more than 1.4 million individuals (CEOs, CFOs, grey and independent directors, ...)
 - ▶ Exact name matching
- Data: Boardex, CRSP, Compustat, Asset4, TR, ...

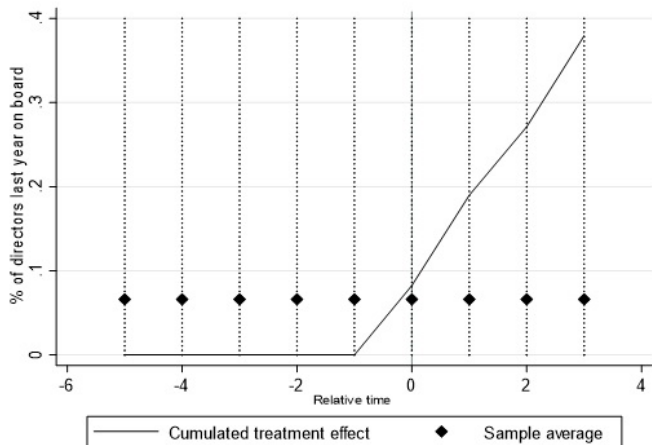
Outside directors of US firms

year	#Director-firms	# SOCADs	#Leak events
2013	32094	668	38
2016	32515	633	32
2017	32026	610	478
2021	27986	473	2

- SOCADs

- ▶ are male,
- ▶ hold a qualification in accounting (but not finance)
- ▶ hold important positions (audit chair, board chair, financial expert)

Probability of leaving



Probability of leaving

	P(Leave)		P(New seats)
	full sample	matched sample	full sample
Leak (t-1)	0.422***	0.751***	na
Controls	yes	yes	yes

Matched sample: 1:1 from same board (seats, grey, age,...)
 ***, **, * sign. at 1, 5, 10% levels

Votes against

	(1)	(2)
Leak (t-1)	1.20***	1.04**
Controls	no	yes

Difference-in-differences (Sun and Abraham, JE 2021)
 match sample from the same board
 ***, **, * sign. at 1, 5, 10% levels

- SOCADs leave their jobs and shareholders vote against them!

Future appointments

	(1) Compensation	(2) Capitalisation	(3) ESG
Existing seats after treatment	0.073**	-0.097***	0.300
New seats after treatment	-0.558*	-0.271*	-3.954
Director FE	yes	yes	yes
Controls	yes	yes	yes

***, **, * sign. at 1, 5, 10% levels

- After the leak, SOCADs obtain less promising appointments.

Stock price response

Window	Single firms		Portfolio	
	(-1, +1)	(-5, +5)	(-1, +1)	(-5, +5)
CAAR	-0.54% ***	-0.91% ***	-0.86% **	-2.14% **
# obs	638	638	5	5

Event study results. Prediction comes from market model.
 ***, **, * sign. at 1, 5, 10% levels

- Share prices respond to the leak information.

Stock price response (2)

	(1)	(2)	(3)	(4)	(5)
Independent	-0.03**				-0.03***
Recently hired		0.02***			0.02***
Certified insider			0.00		-0.00
SOCAD insider				-0.01**	-0.00
Controls	yes	yes	yes	yes	yes

***, **, * sign. at 1, 5, 10% levels

- If monitoring function is relevant, the effect is most pronounced.

Other channels of market discipline

	$\Delta Sales$	$\Delta \# Employees$	$\Delta Debt$	$\Delta InstInv$
Post	0.025	-.029*	-.069	-5.78

Difference-in-differences (Sun and Abraham, JE 2021)
 PS 1:1 matched for SOCADs on board
 ***, **, * sign. at 1, 5, 10% levels

- No consistent evidence that other stakeholders respond to the leak information.

Corporate news' credibility after the leak

- Do investors interpret corporate news differently after the leak?
- Focus: Market-adjusted return after earnings announcements

	full sample		matched sample	
<i>Surprise</i>	8.89***	8.89***	11.36***	11.37***
<i>Surprise · Leak(t - 1)</i>	8.18**		3.77	
<i>Surprise · Leak(t - 1) · remain</i>		4.92		-0.13
<i>Surprise · Leak(t - 1) · left</i>		18.06**		24.84***
Firm FE	yes	yes	yes	yes
Controls	yes	yes	yes	yes

***, **, * sign. at 1, 5, 10% levels

- Firms gain credibility if SOCADs left the board.

Extensions and robustness

- Extensions
 - ▶ Classified boards determine career path of SOCADs.
 - ▶ Probability of leaving is moderated by firms' reputation and governance, but not by SOCAD characteristics.
 - ▶ Leak events spill over to other firms via the shared director channel.
- Robustness
 - ▶ Control for confounding events
 - ★ SOCADs with news before the leak (Google search volume),
 - ★ SOC-affiliated inside directors.
 - ▶ Quality checks of the match
 - ★ Name frequency (e.g. Mark Smith)
 - ★ Name uniqueness (a matter of string length)

Summary

- Directors' careers are negatively affected.
- Firms are negatively affected (negative CAR, but no effect on sales, employment, and institutional holdings).
- Earning surprises gain credibility after the leak if SOCAD left the firm, indicating that trust is restored.

Thank you for your attention.

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