Reputation Repair After a Restatement

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Comments welcome

Abstract:

How can reputations be repaired after being damaged in a financial reporting scandal such as an earnings restatement? We read 23,078 press releases and identify 1,224 reputation-building actions taken by 94 randomly selected restating firms to answer this question. We posit that firms have incentives to target multiple stakeholders, such as their capital providers, employees, customers, and their geographic communities, in a reputation repair strategy. Consistent with our hypothesis, we observe significant increases in the frequency and abnormal stock returns to reputation-building actions targeted at these stakeholders in the year after the restatement relative to a control period. Moreover, we predict and find that firms that rely heavily on implicit claims with their customers, employees or communities are more likely to take reputation-building actions targeted at these specific stakeholder groups. Finally, we show that actions targeted at both capital provider and other stakeholders are associated with improvements in the restating firms financial reporting credibility.

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