Investing in managerial honesty

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Abstract: Two laboratory experiments show that investors perceive a CEO to be more committed to honesty when the CEO resisted, at a personal cost, engaging in earnings management. A one standard deviation higher CEO's perceived commitment to honesty compared to another CEO reduces the relevance, for investment decisions, of differences between the CEOs' claimed future returns by 40%. This interaction effect is prominent among investors with a pro-self orientation. To pro-social investors, their own honesty values and those attributed to the CEO matter directly, not through the returns. Overall, CEO honesty matters to different investors for distinct reasons.