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CEO Speeding Tickets, Luxury Spending Could Be Early Warning of Fraud

By Gregory Millman

Boards considering a new chief executive hire don't usually put much weight on the fact the candidate might have gotten a speeding ticket at some point but maybe they should.

Research shows CEO recruits who have had even one minor legal infraction, such as a speeding ticket, are seven times more likely to engineer an accounting fraud than CEOs with completely clean records, according to the study's lead author, Robert Davidson, a professor in Georgetown University's McDonough School of Business.

What's more, Prof. Davidson said CEOs with a taste for the high life, as measured by ownership of a yacht, a high-end car, or a a costly home, are 10 times more likely to preside over firms where other executives engineer frauds.

These findings fly in the case of conventional recruitment wisdom. Richard McCallister, managing partner of Boyden Global Executive Search's Chicago office, said that although a CEO with a thick deck of traffic citations or other legal infractions might raise yellow warning flags, a single ticket wouldn't: "Usually it's immaterial." The same is true of a candidate with one or a few luxurious possessions. "Having an expensive car or an expensive house kind of goes with the package of a successful person," said Mr. McCallister, who explained as long as legal infractions or luxury goods aren't "excessive," they don't raise eyebrows.

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Robert Davidson
Georgetown University's
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The study finds even a single infraction or indulgence can matter. Titled "Executives' Off-the-Job Behavior, Corporate Culture, and Financial Reporting Risk," the study compared firms involved in fraud during the period 1992-2006 with firms matched for size, CEO age and other factors. The size of the sample was small, only 109 firms involved in fraud and 109 not. Professor Davidson said it included "every case of fraud from an S&P 1500 firm" during the period.

"In our fraud sample 21% of CEOs had broken the law, and in the non fraud sample it's 5%," Prof. Davidson explained. Some of the CEOs in the fraud sample had done more than get speeding tickets. Driving under the influence, domestic violence, drug charges, a bar fight, and reckless behavior also cropped up among the firms involved in fraud. "With regards to more serious crimes, there was not a single CEO in the no-fraud sample who had committed a crime other than a traffic violation. We had 12 in the fraud sample," Prof. Davidson said.

He explained the research looked at frugality of CEOs, defining non-frugal CEOs as those who owned a boat longer than 25 feet, a home worth more than double the price of real estate in the area, or a car worth more than $75,000.

CEOs who are unfrugal by these standards, he said, “change the composition of the firm’s board, change the compensation structure of the board, and also have different hiring practices for the senior executive team.” Such CEOs are likelier to pick board members with whom they have social or professional connections, likelier to reduce the incentive proportion of the board’s own compensation, and also to hire similarly-unfrugal CFOs. Subsequently, “they were running firms where somebody in the firm was more likely to commit fraud.”

The byword in CEO recruitment has been “don’t sweat the small stuff.” But the lesson of this research is “there’s information in the small stuff, it matters,” Prof. Davidson said.

Davidson said the study has been accepted for publication in the Journal of Financial Economics. Link to the study here.

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