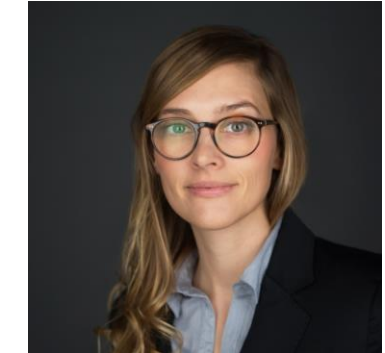


The Stronger, the Higher, the Better?

Experimental Evidence on the Effect of Clawback Provision Strength and Discretion in Clawing Back Performance-based Payment on Honesty in Reporting

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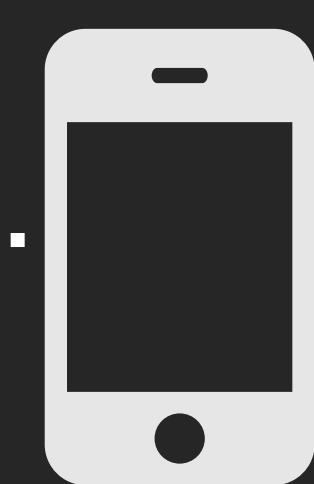
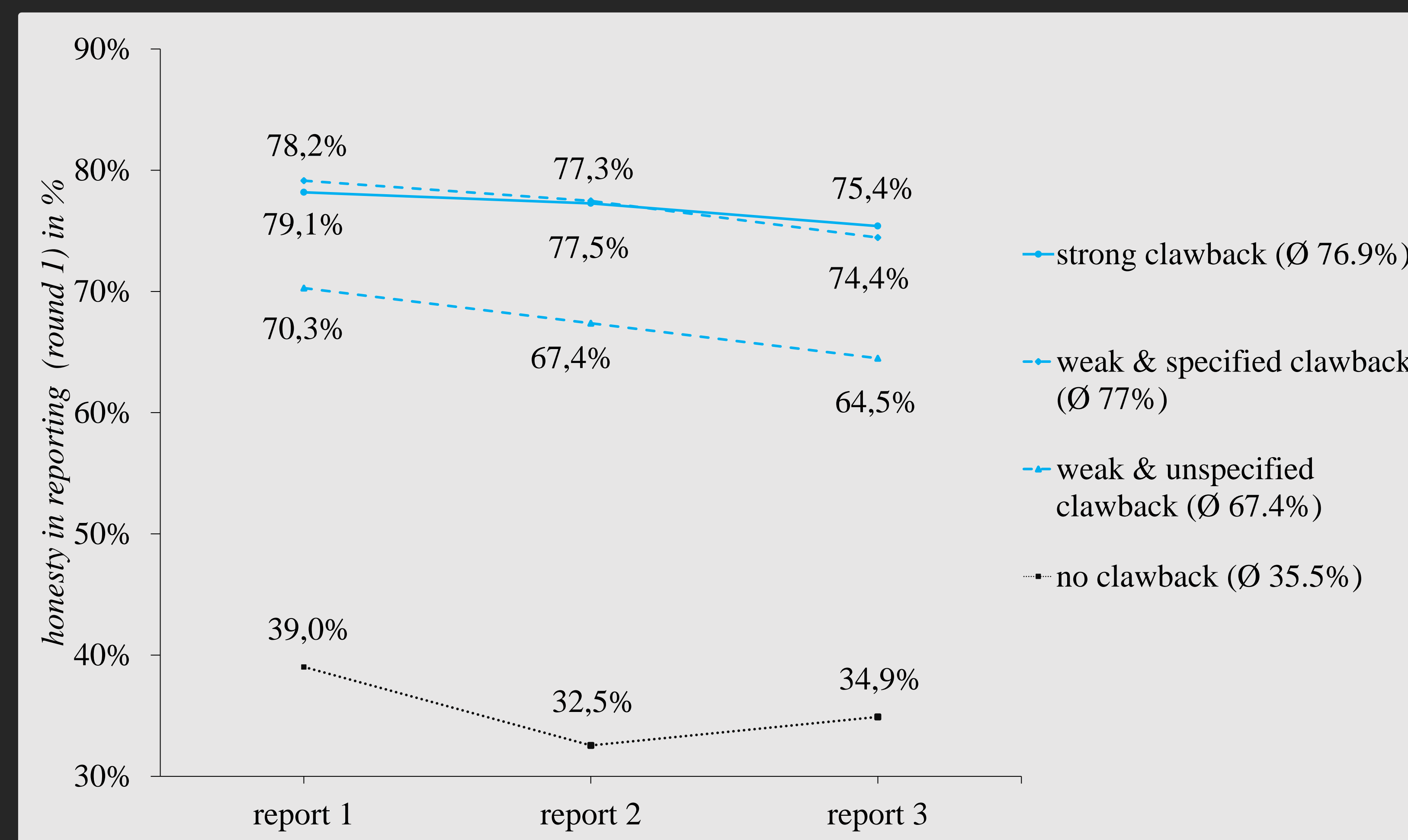
OBJECTIVE: Our study complements archival evidence on the effect of clawbacks on reporting behavior and provides empirical evidence on causal direct effects using a behavioral experiment.

METHOD: BEHAVIORAL EXPERIMENT: To test our research hypotheses we conducted a behavioral experiment with a 3 (clawback provision strength) x 4 (discretion to execute clawback) between-subjects design. In addition, we included one control condition without a clawback, thus we had 13 experimental conditions.

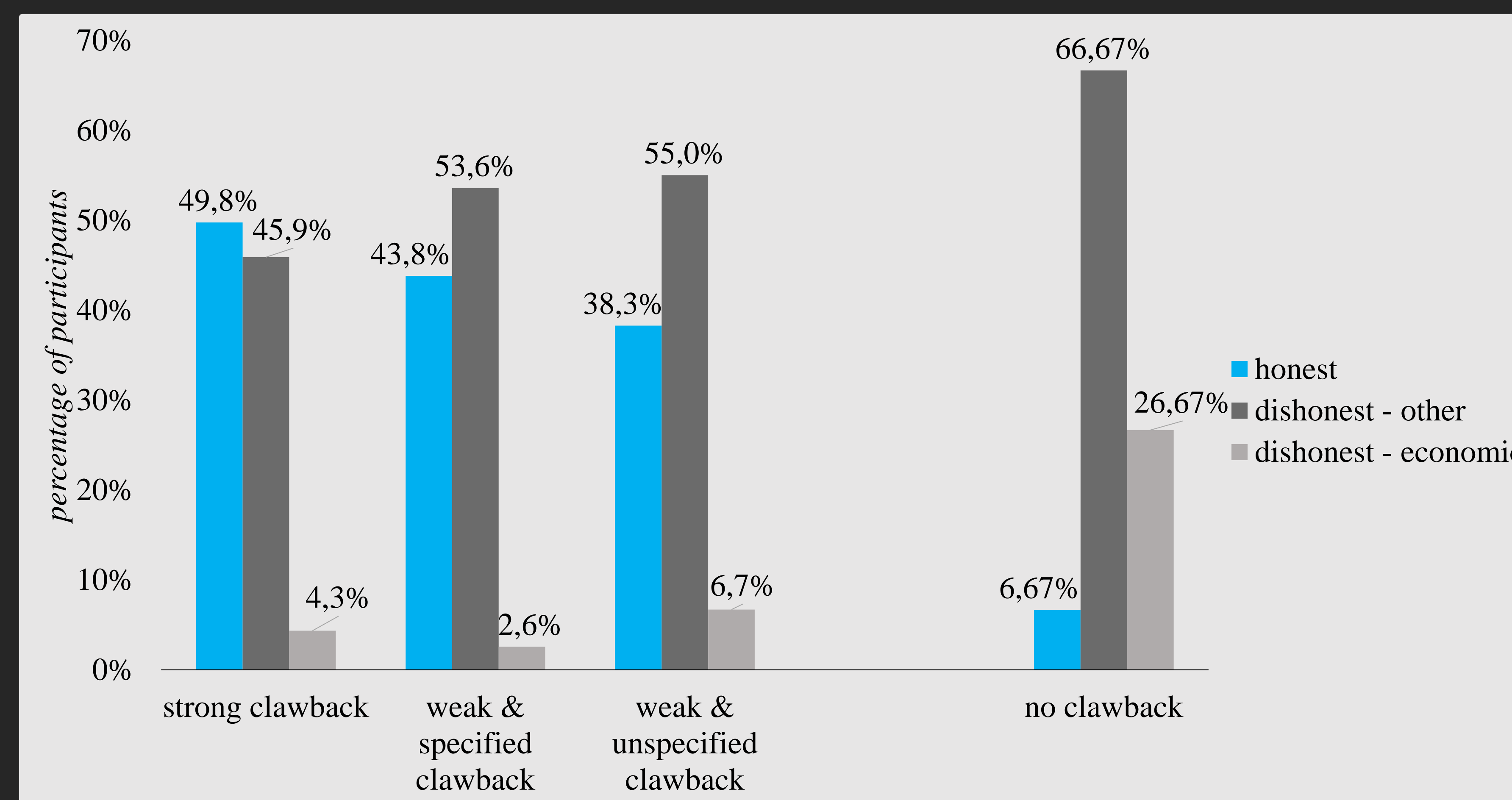
RESULTS: The results show that...

- a performance-based incentive system with a clawback leads to sig. higher honesty in reporting than a performance-based incentive system without a clawback.
- ... with increasing clawback strength – from weak & unspecified to weak & specified to strong – the percentage of honestly reporting participants steadily increases ($F(3/636) = 18.461; p = 0.000^{***}$).
- ... in every discretion condition the average honesty in reporting sig. increases, even in the condition in which the participants experienced, despite their dishonest reporting behavior, no clawback ($F(4/595) = 13.032; p = 0.000^{***}$).

The findings of the study show that clawbacks significantly increase honesty in reporting.



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EXPERIMENTAL CONDITIONS

clawback strength	discretion to execute the clawback				no clawback exercised because participants reported honestly in round 1
	clawback exercised fully	clawback exercised partly level 1	clawback exercised partly level 2	clawback not exercised	
strong Ntotal = 207	n = 21 hr_1 = 50.9% hr_2 = 52.6%	n = 26 hr_1 = 50.8% hr_2 = 65.9%	n = 32 hr_1 = 63.3% hr_2 = 69.6%	n = 25 hr_1 = 48.5% hr_2 = 59.2%	n = 103 hr_1 = 100% hr_2 = 95.5%
weak & specified Ntotal = 194	n = 26 hr_1 = 58.4% hr_2 = 74.1%	n = 24 hr_1 = 56.0% hr_2 = 67.9%	n = 30 hr_1 = 56.9% hr_2 = 73.7%	n = 29 hr_1 = 64.6% hr_2 = 68.4%	n = 85 hr_1 = 100% hr_2 = 96.0%
weak & unspecified Ntotal = 209	n = 30 hr_1 = 44.4% hr_2 = 68.6%	n = 29 hr_1 = 56.5% hr_2 = 62.1%	n = 30 hr_1 = 50.8% hr_2 = 61.1%	n = 40 hr_1 = 39.6% hr_2 = 54.0%	n = 80 hr_1 = 100% hr_2 = 95%
no clawback Ntotal = 30	n = 28 hr_1 = 30.9% hr_2 = 29.8%				n = 2 hr_1 = 100% hr_2 = 100%

hr_1 is the average honesty in reporting in round 1; hr_2 is the average honesty in reporting in round 2.

HYPOTHESES

- H1: Incentive system with clawback → higher honesty in reporting
- H2: Stronger clawback → better reporting behavior
- H3: More discretion of the board → lower clawback effectiveness

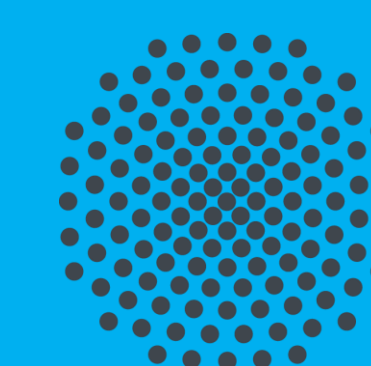
CONCLUSION

Our findings provide empirical evidence that clawback adoption causes a significant increase in honesty in reporting. These findings can serve as an explanation of the decrease in restatements of financial statements that comes with the adoption of clawback provisions found by several archival studies. In addition, our findings contribute to the clawback research because we show the significant detrimental effect when applying too much discretion when executing a clawback.



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