

JOHN ZHANG

University of Liverpool, United Kingdom

PROTECTION OF TRADE SECRETS AND CEO RISK-TAKING INCENTIVES

Abstract:

Using the adoption of the inevitable disclosure doctrine (IDD) by U.S. state courts over the period 1993 to 2012 as a natural experiment, we investigate the impact of the protection of trade secrets on chief executive officer (CEO) risk-taking incentives. IDD is a legal doctrine that forbids a firm's former employees from working for a rival firm if this would lead to the inevitable disclosure of trade secrets. We argue that IDD adoption induces firms to provide more risk-taking incentives to their CEOs, because it reduces competitive threats and makes risky investments more valuable. Consistent with our prediction, we find that IDD adoption leads to firms providing more CEO risk-taking incentives, as reflected in the higher vega of CEO equity compensation. We also find that our findings are more consistent with the 'profit sharing concerns' argument rather than the 'career concerns' argument. We further find that the IDD-related increase in vega leads to a subsequent increase in firm risk taking.

Keywords:

CEO Risk-Taking

Protection of Trade Secrets

inevitable disclosure doctrine

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