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SEARLE CIVIL JUSTICE INSTITUTE

THE FOREIGN CORRUPT
PRACTICES ACT:
Economic Impact on
Targeted Firms

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SEARLE CIVIL JUSTICE INSTITUTE

Founded in 2008, the Searle Civil Justice Institute (SCJI) is a nonpartisan public policy institute based at George Mason University's Law & Economics Center. The SCJI's core mission is to provide research regarding the impact of laws and regulations on economic growth that is analytically rigorous, balanced, accessible, and useful to policy makers. The SCJI works diligently to maximize the effectiveness of such research through large-scale public policy conferences, public policy reports, and an extensive communications strategy.

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EXECUTIVE SUMMARY

In December 1977 Congress passed the Foreign Corrupt Practices Act (FCPA),¹ making the U.S. the first country to prohibit payments to foreign government officials to secure a business advantage. For most of the FCPA's existence, enforcement actions were rare. In recent years, however, the Department of Justice (DOJ) and the Securities Exchange Commission (SEC) (collectively, "the Agencies") have markedly increased their enforcement of the FCPA. To date, the debate over the FCPA's cost to firms has proceeded without much systematic evidence. To fill this void, the Searle Civil Justice Institute (SCJI) gathered data on FCPA enforcement actions involving foreign bribery. In August 2012, the SCJI released its first report (the "2012 Report"), which provided a descriptive analysis of FCPA enforcement actions over time.² This 2014 Report covers all bribery-related FCPA actions through April 2013, and expands on the 2012 Report by exploring the economic impact of FCPA enforcement on targeted firms.

Key Findings

- Targeted firms tend to have a high equity value.
 - Of the 139 total firms in the sample, 76 reside in the top decile of Compustat firms and only 9.4 percent reside in the bottom five deciles.
- Targeted firms concentrate most in the heavy manufacturing, pharmaceutical and healthcare, and oil and gas industries.
- Targeted firms' expected return on investment for bribes to foreign officials is high.
 - 85.6 percent of bribes are intended to elicit increased sales, whereas only 7.2 percent are given in exchange for political and regulatory favors.
 - On average, the ratio of bribe to sales influenced is 5.87 percent, and over the entire violation period the firm's projected sales increase by 4.52 percent due to the bribe-related sales increase.
- The announcement of an FCPA investigation decreases the value of a firm.
 - The initial revelation is associated with an average decline in market capitalization for the targeted firm of 2.9 percent.

¹ Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, 91 Stat. 1494 (codified as amended at 15 U.S.C. §§ 78a, 78dd-1, 78dd-2, 78ff, 78m, 78o.).

² *The Foreign Corrupt Practices Act: An Empirical Examination of Enforcement Trends, Phase I*, George Mason University Law & Economics Center Searle Civil Justice Institute, Sept. 2012, available at <http://www.masonlec.org/programs/45>.

- The specific FCPA charge, however, has a large impact on firm losses.
 - Firms charged only with bribery experience an initial average 1.5 percent reduction in market capitalization, and an average cumulative reduction in value of 2.7 percent.
 - Firms charged with both bribery and financial fraud experience an average initial loss in value of 16.3 percent, and an average cumulative loss in value of 54.9 percent.
 - This trend remains true across industries.
- Reputational losses can overwhelm direct costs when a firm is charged with both bribery and financial fraud.
 - The direct costs of an FCPA enforcement action explain the loss of value for firms engaged in bribery, but not for firms charged with bribery and financial fraud.
 - Indirect costs, in the form of cumulative shareholder loss, represent a 46.3 percent reduction of market capitalization for firms accused of both bribery and financial fraud.

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