THE COSTS OF CORPORATE CRIMINAL PROSECUTIONS

New research to appear in the *Journal of Management* shows that prior research may have underestimated the decline in stock price that comes from a prosecution on criminal charges. A new look at the impact of criminal charges on shareholder value suggests that the decline may be priced into the market gradually, as information about the allegation, evidence, and a firm’s reaction become known. Altogether, the stock price may decrease as much as 11%, about three times the prior estimate.

Using data from 177 criminal actions involving at least $100,000 in sanctions, the author examined specific events in the long process of prosecution. He observed that information about the case emerged in two broad phases – an accusative phase and an adjudicative phase. Firms’ stock prices adjusted gradually within each phase, to pieces of information like a manager’s personal plea deal, or a company’s signaling their response in a press release. He found that the most impactful events were the initial notification event (e.g., when regulatory agents or a whistleblower first notify law enforcement), and the announcement of formal charges.

The author’s calculations indicate that the decline in shareholder wealth far exceeds the value of sanctions that are expected or imposed. He concludes that every dollar of direct fines or sanctions is accompanied by an additional $5 of shareholder wealth lost because of reputational effects and customer perceptions.

According to the study’s author, the decline in stock price means that the financial penalty for a firm’s criminal action is not borne by the perpetrators, but largely by shareholders, who are relatively innocent. Knowing whether these penalties encourage board oversight and promote legal compliance will require more research. The author advises that transparency and individual accountability for decisions may be the key to preventing criminal managerial actions.

**Key Takeaways:**

- When a firm is prosecuted for criminal behavior, the resulting decline in stock returns averages almost 11%.
- Most of the decline is due to reputational costs, which the author estimates to be five times the financial penalties of a settlement or judgment.
- The decline in stock price arises over a series of events from notification to sentencing. It does not take place all at once in response to conviction or sentencing.


---

**Center for Executive Succession: RESEARCH BRIEF**

For more information on this or other Center for Executive Succession research, contact us at: CES@moore.sc.edu

Please note that CES seeks to share the published findings regarding C-Suite issues but does not necessarily endorse the research.