Scandals not bad for business in the long term, study finds

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Scandals involving bosses of major firms have no long-term negative impact on share prices and can even lead to better performance, University of Sussex research has found.

The corrective measures put in place after a scandal translate into improved operating performance, often outstripping that of scandal-free rivals, according to the researchers.

Nonetheless, the short-term consequences for shareholders are dire. Chief executives committing fraud or taking part in insider trading end up costing shareholders dearly in the days following the news of the scandals.

In a study of 80 corporate scandals in the USA, share prices plummeted between 6.5% and 9.5% in the month after the misconduct was made public, collectively costing shareholders an average of $1.9 billion (£1.25 billion) per scandal-hit firm.

And it is not just limited to financial misdemeanours – personal scandals such as having an affair, lies on CVs (resumes) and harassment cases had just as much impact.

However, the negative effects did not last long. Three years on, the share-price performance of the same firms matched those that had not been affected by scandals.

If anything, the 80 companies in the study – including Apple, Hewlett Packard, IBM, JP Morgan and Yahoo - actually showed an improved operating performance in the years after a scandal.

University of Sussex economist Dr Surendranath Jory led the research, published in the journal of Applied Economics.

They looked at the Return on Assets (ROA) score of the companies in the study, as a measure of how efficient the firms are at using their assets to generate earnings.

They found that those who had survived a scandal involving their Chief Executive Officer (CEO) had ROA scores up to 10 per cent better than other rival companies.

Dr Jory says that this may be down to protections put in place following a scandal, such as appointing independent board members or capping severance packages for top executives. He says: "Corporate scandals can act as a catalyst to implement changes that benefit investors. The companies put in place safeguards to protect against future abuses, and they seem to work."

Dr Jory was surprised, though, by the suddenness of the initial fall in share price.

He says: "I thought that noise of corporate misdeeds would have leaked prior to official announcements and that investors would have already priced in the negative consequences of those crimes days before the announcements. But it seems that investors wait for something more tangible before reacting - for instance, an announcement in the media."

Dr Jory, alongside colleagues at East Carolina University and the University of Texas-Pan American in the USA, examined corporate scandals between 1993 and 2011 that were expressly linked to a firm's CEO.

More information: "The market response to corporate scandals involving CEOs." DOI: 10.1080/00036846.2014.995361

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