Economic Consequences of Financial Reporting Fraud

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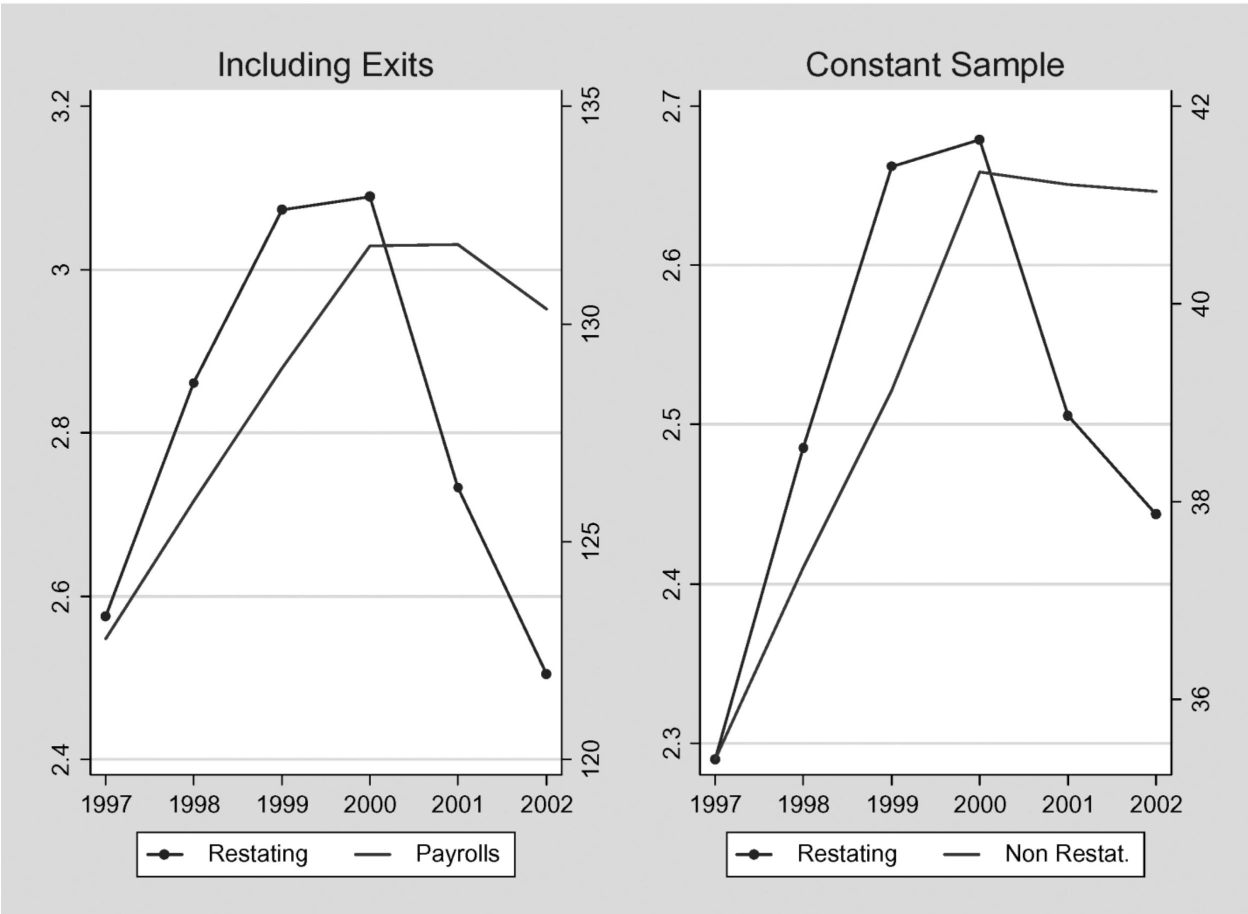
Employment Levels



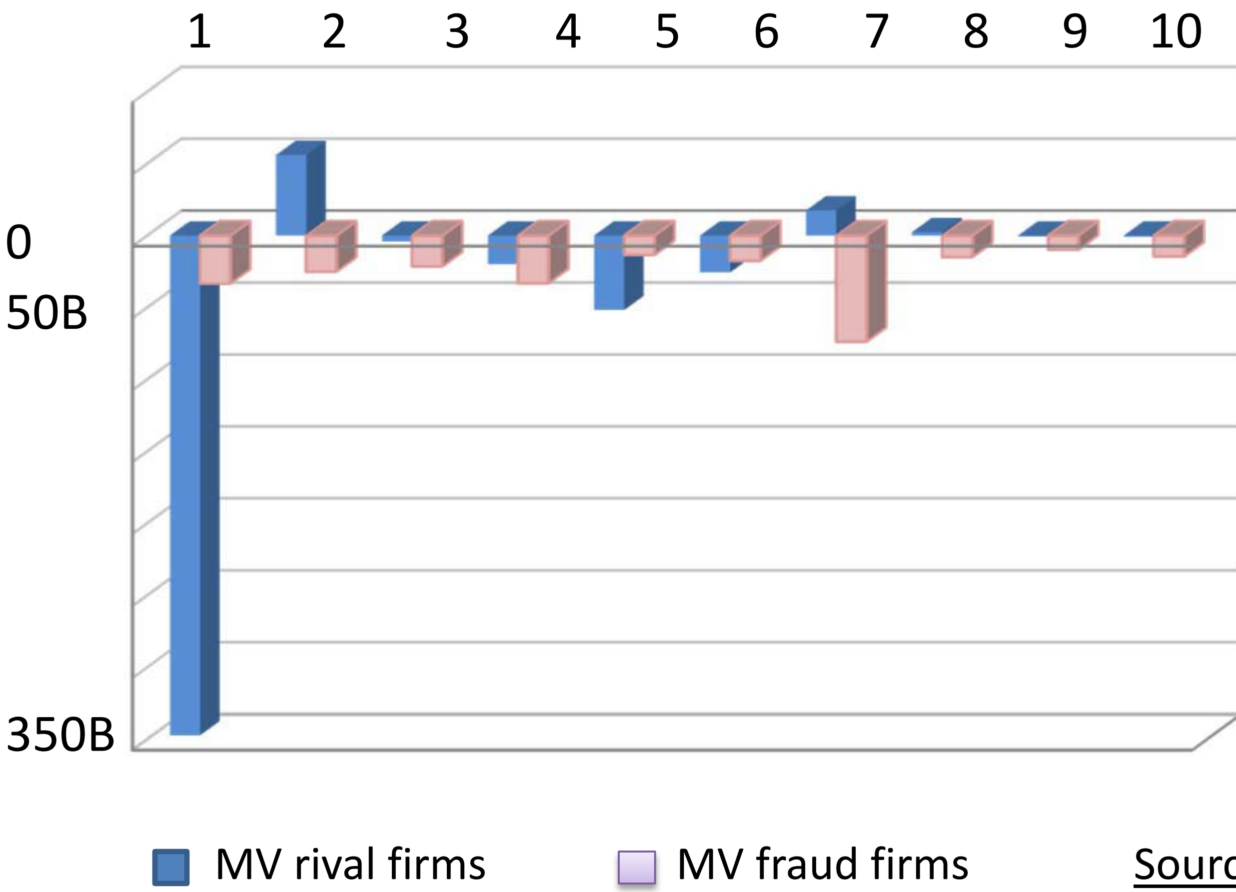
- Kedia & Philippon (2009)
- <u>Fraud firms</u>: 25% increase (500,000), followed by decrease of 600,000
- <u>All firms</u>: 6.7% increase, followed by 1.5% decrease

Effects on Rivals: Stock Prices, Investment, Debt

Restatement Returns (-1, +1)	**Restating Firm**	**Peer Firms**	**Aggregate Losses**
Gleason, Jenkins & Johnson (2008)	-19.8%	-0.5%	n/a
Durnev & Mangen (2009)	- 8.28%	- 0.34%	$141M fraud firm; $581M rival firms
Goldman, Stefanescu & Peyer (2011)	- 19.7%	- 0.54%	[next slide]

- Higher cost of **debt** post-restatement by fraud firms and non-fraud rivals, Files & Gurun (2011)
- Reduced **investment** post-restatement by fraud firms and non-fraud rivals, Durnev & Mangen (2009)
- Higher cost of capital: higher risk (contagion), lower expected payoff as industry prospects are revealed to be less rosy.

Effects on Rivals: Aggregate Market Value Losses by Industry Concentration (Herfindahl Index Deciles)



Source: Goldman, Peyer, Stefanescu (2011)