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Corporate Governance Characteristics of FCPA Violators

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Introduction

Corruption and bribery are worldwide diseases that cannot be cured, only managed. Corporate bribery erodes public confidence in the markets because it damages the integrity of the free market system by replacing competition with corruption resulting in an unequal distribution of power, wealth and opportunity (Transparency International, 2016). Thus, corporate bribery is not only unfair and illegal, but also has terribly corrosive effects on business, government, society and overseas economies. The United States' weapon of choice for combating transnational commercial bribery is the Foreign Corrupt Practice Act (FCPA) of 1977. This anti-bribery law makes it illegal for U.S. nationals, residents and U.S. companies—as well as certain foreign companies, e.g., those listed on U.S. stock exchanges—to make payments to any foreign official for purposes of obtaining or retaining business. The FCPA has two groups of provisions to control this supply side of corruption: (1) anti-bribery provisions, and (2) accounting (books and records, and internal controls) provisions. There are two organizations that enforce the FCPA: the Department of Justice (DOJ) responsible for all criminal enforcement of the FCPA provisions, and the Securities and Exchange Commission (SEC) that can bring civil actions against any FCPA violator (U.S. or foreign company) that listed their securities on U.S. stock exchanges. Although the FCPA remained relatively dormant for its first 24 years (1977–2000) with only 33 modest-sanction enforcements against corporations, the FCPA is now in the midst of an unprecedented surge in enforcement. From 2001 to 2016, the DOJ and the SEC took actions against 135 corporations. The year 2016 was a record-breaking year with 24 FCPA enforcements against public companies by the SEC. Enforcement actions continue to target both U.S. and foreign firms. The DOJ now calls FCPA enforcement one of its highest priorities, second only to combating terrorism (Yockey, 2013). The SEC also considers FCPA enforcement a high priority area as its Enforcement Division created a specialized unit in 2010 to further enhance its enforcement of the FCPA. Kanter (2017), who analyzed SEC enforcement cases from 2008 to 2014, finds that violations of the FCPA resulted in the highest penalties, averaging $43.8 million per case, and in total constituting 47 percent of the penalties the SEC assessed in all fraud cases during the six-year period.

Regardless of the recent increase in FCPA enforcement activities and the tremendous penalties of FCPA violations, there has been no empirical study that investigates corporate governance characteristics of companies that violated the FCPA. This study is the first one to empirically examine the relationship between corporate governance characteristics and the likelihood of FCPA violation. Stronger and more effective corporate governance is needed to ensure that multinational corporations conduct their business in an ethical manner and are in compliance with the FCPA (Darrough, 2010; Lestrange and Tolstikov-Mast, 2013). An increasing emphasis on corporate governance by the Sarbanes-Oxley Act (SOX) of 2002 has led the SEC and the DOJ to evaluate the effectiveness of corporate compliance/corporate governance programs when they conduct FCPA investigations and impose penalty because such programs are crucial for preventing, detecting and remediating misconduct concerning FCPA violation (U.S. DOJ and U.S. SEC, 2012).

An examination of corporate governance of FCPA violators is, therefore, important not only to regulators but also to multinational corporations, investors and academicians. In particular, this study has four contributions. First, its findings could help the DOJ and the SEC more effectively identify a firm susceptible to a possible FCPA violation given that these two regulators mainly rely on tips and self-disclosure by companies. Second, its findings could help top management and board of directors improve their corporate governance mechanisms in order to reduce the FCPA-violation likelihood. The negative consequences of indictment or conviction could be disastrous for companies. Firms can suffer tremendous harm to their reputation just from being thought of as "criminal" even as early as the investigatory stage. Firms in some regulated industries could also lose their licenses or permits to operate, and others could become

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ineligible to receive U.S or foreign government contracts or funds from international finance resources. Additional harms include challenges with recruiting well-qualified employees, maintaining good relationships with existing suppliers and customers, and facing separate civil shareholder class-action suits. Third, investors could use this study's findings to identify firms with potential FCPA-compliance problem so as to avoid investment loss given that Persons (2006) documented a significantly negative stock-market reaction to announcements in the *Wall Street Journal* about non-financial-reporting violations including the FCPA violation. Fourth, this study contributes to the FCPA and corporate-governance literature as it is the first one to empirically investigate corporate governance characteristics that mitigate the likelihood of FCPA violation.

Characteristics of FCPA Violators

There are two published studies, Darrough (2010) and Burnham et al. (2018) that examine characteristics of FCPA violators. However, the main theme of Darrough's study is to qualitatively evaluate the effectiveness of the FCPA and to offer lessons learned from the FCPA. The empirical part of Darrough (2010) involves only 43 FCPA violators and provides descriptive statistics of only three financial characteristics during the year of FCPA enforcement: size, profitability, and competitive nature of the industries. Burnham et al. (2018) investigated the FCPA-violation likelihood and: (1) firm performance relative to aspirations and (2) investments in marketing and RandD. Unlike these two studies that did not examine any corporate governance characteristic, this study investigates the following seven corporate governance characteristics of 125 FCPA violators while controlling for size, industry and profitability. One of these seven corporate governance characteristics, tenure of legal counsel, has never been examined in any empirical corporate-governance study.

1. CEO Duality

According to the agency theory, CEO duality could undermine the monitoring functions of the BOD because a CEO who is also a BOD chairman could exert an undue influence over the board by controlling the board agenda and the flow of information to the board as well as handpicking directors who would not challenge the CEO (Jensen, 1993). Dechow et al. (1996) find that firms manipulating earnings were more likely to have CEO duality. Davidson et al. (2004) find a greater income-increasing earnings management following duality-creating successions than non-duality-creating successions. Persons (2005) reports that firms engaging in financial-statement fraud tended to have CEO duality. Ehikioya (2009) finds that CEO duality adversely affects firm performance. In all, these studies imply that CEO duality may motivate managers to engage in questionable or illegal conduct like bribery to improve firm performance.

On the other hand, managerial stewardship theory suggests the benefits of CEO duality such as a unity of command, accountability in corporate leadership, and organizational flexibility and adaptability (Brickley, et al., 1997; Faleye, 2007). To take timely actions necessary to capture the market opportunities in a fast-changing environment, the combined leadership of CEO duality helps clarify a unity of command and leadership accountability, which effectively keeps non-executive directors informed and reduces the chance of political deadlock between the executive and the board. Relying on the governance substitution theory, Wang et al. (2019) find that boards of directors who can effectively monitor their CEOs are more likely to adopt the CEO-duality governance structure. Song and Kang (2019), and Kim (2013) find that firms with CEO duality have superior firm performance when the firms have extensive corporate or geographic diversification. Burnham et al. (2018) find that superior-performance firms are less likely to engage in bribery. Because of these contrasting perspectives and conflicting research evidence, there is no expectation about the relation between FCPA violation and CEO duality.

2. CEO Tenure

Taniman and O'Shannassy (2015) argue that CEO tenure is positively related to firm performance because the board of directors retains only a good-performing CEO who is a competent steward of firm resources and has strong alignment between his/her interests and those of the firm and stakeholders. O'Sullivan et al. (2016)'s finding of a positive relationship between CEO tenure and bank performance supports this argument. Persons (2006) also asserts that long-tenure CEOs have lower incentive to commit fraud because they have a well-established reputation and legacy to protect. Similarly, Danoub et al. (1995) argue that CEO with shorter tenure may be more prone to initiate or be involved in illegal activities than CEOs with longer tenure. Danoub et al (1995) explained their argument by using two factors: executive mobility and pressure to prove legitimacy. More mobile CEOs with less tenure are often more aggressive and tend to engage in risk-taking so as to advance their own rapid career achievement (Clinard, 1983). Therefore, shorter-tenure executives may respond to external threats from changing environmental and competitive conditions by engaging in illegal activities. In addition, newly appointed CEOs are likely subject to higher pressure to show their managerial competence in terms of favorable financial performance (Shen, 2003). These short-tenured CEOs who face likely shortfall in financial expectation of the board and stockholders may be tempted to engage in illegal activities such as bribery to obtain more revenue/profit. This line of arguments is supported by empirical evidences from: (1) Persons (2006) that firms engaging in non-financial reporting fraud are likely to have CEOs with shorter tenure, and (2) Ebrahim (2007) that shorter CEO tenure is associated with higher discretionary accruals.

3. Tenure of General (Legal) Counsel

Section 307 of Sarbanes-Oxley Act (SOX) of 2002 instructs the SEC to adopt "minimum standards of professional conduct for attorneys" by: (1) requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent to the chief legal counsel or the chief executive officer, and (2) if the counsel or officer does not appropriately respond to the evidence, requiring the attorney to report to the audit committee of the BOD. On January 23, 2003, the SEC approved Rule 205, which incorporates the statute reporting requirements for corporate counsels. The role of the general counsel, therefore, has become more complex and demanding after the Sarbanes-Oxley Act.

The role has evolved from a lawyer purely practicing law into a top executive who must have not only legal acumen but also solid knowledge of the business matters especially in the areas of risk analysis and corporate governance (Nishizawa, 2007). A strong understanding of the company's accounting and financial health is crucial for a business counseling function in the general counsel's role (Flahardy, 2005). Obtaining a solid understanding of a company-specific accounting, corporate governance, financial health and risk of different business units of a multinational corporation definitely requires years of firm-specific experience. Such thorough understanding of business sense is a must for the successful compliance with the FCPA given that this law has both an accounting provision and a bribery provision. In particular, the general counsel must effectively assess the company's FCPA risk by considering where it does business, with whom it does business, and how it does business (Klehm and Roseman, 2010). A thorough FCPA risk assessment and an effective implementation of anti-corruption controls could be especially challenging and very time-consuming for a large multinational corporation that has businesses all around the world. This study, therefore, uses the tenure of general (legal) counsel as a measure of how experienced the general counsel was with the firm specific FCPA risk management. We expect FCPA violators to have the general counsel with a shorter tenure (less firm-specific experience) than that of their matched firms.

4. Board Independence

A board of directors has a critical role with respect to FCPA compliance. The Federal Prosecution/Sentencing Guidelines require that a board must exercise reasonable oversight and "independent" review of the implementation and effectiveness of the compliance and ethics program (Klehm and Roseman, 2010). A more independent board, comprised mainly of independent outside directors, can perform a better function of decision control and monitoring activities of top managers (Jensen, 1993). Beasley (1996) found that larger proportion of outside independent directors on the board significantly reduced the likelihood of financial statement fraud. Klein (2002) documented less abnormal accruals when the BOD was more independent from management. Bedard et al. (2004) and Hamid et al. (2014) find a negative relation between the board independence and aggressive earnings management. Virk (2017) finds that corporate illegality is less likely to occur when a large proportion of the board consists of independent directors. These studies suggest that a more independent board is likely to provide a better oversight over the company operation including the FCPA compliance program, hence, reducing the likelihood of FCPA violation.

5. Audit-Committee Meeting Frequency in a Year

Menon and Williams (1994) posit that meeting frequency signals diligence and liability concern of audit-committee directors. Abbott et al. (2003) find that firms with audit committees comprised solely of independent directors that meet at least four times annually have significantly smaller ratio of non-audit fees to audit fees. This finding seems to suggest that an audit committee that meets more frequently is better at complying with regulation, specifically the Sarbanes-Oxley Act which prohibits an auditor from providing eight non-audit services to an auditing client because a high level of non-audit fees could compromise the auditor independence. Abbott et al. (2004) also find that firms have lower occurrence of financial reporting restatements if their audit committee meets at least four times annually. DeZoort et al. (2002) synthesize audit committee literature and conclude that greater audit-committee meeting frequency is clearly associated with a reduced incidence of financial-reporting problems and greater external-audit quality. Ho et al. (2014) find that, in the post-SOX era, a more diligent audit committee that meets more frequently curbs managers' tendency to use downward forecast guidance to meet or beat quarterly-earnings targets. These studies provide evidence in support of the view that audit committee which meets more often is more effective in monitoring management and achieving better compliance which can potentially reduce the likelihood of FCPA violation. Therefore, a negative relation between audit-committee meeting frequency and FCPA-violation likelihood is expected.

6. Accounting Expertise of Audit-Committee Members

The SEC's initial proposal to implement Section 407 of the Sarbanes–Oxley Act on audit-committee financial expertise was to mandate public companies to disclose whether its audit committee employed at least one accounting expert, e.g., a CPA, a chief financial officer, a financial controller (SEC, 2002). In response to the public's outcry that there would be insufficient qualified candidates to serve as accounting experts, and that stringent definition would exclude some qualified experts that developed accounting expertise ''on the job'' (e.g., Warren Buffett or Alan Greenspan), the SEC adopted a more liberal definition of financial expertise, i.e., anyone with experience in accounting, supervising financial professionals or overseeing the performance of a company (SEC, 2003). This broader definition includes CEOs, BOD chair, executive directors, partners or principals in venture financing, investment banking, or money management.

The SEC's initial position implied that an accounting expert on the audit committee is more effective than a financial expert that lacks the accounting credentials and expertise. This position is subsequently supported by several research studies. DeFond et al. (2005) find that the appointment of an accounting expert to the audit committee receives a more favorable reaction by the market than the appointment of a non-accounting financial expert. Krishnan and Visvanathan (2008) and Dhaliwal et al. (2010) find that firms with an accounting expert serving on the audit committee exhibit more conservative accounting and higher accrual quality than those firms without an accounting expert on the audit committee. Bryan et al. (2013) finds that earnings quality is significantly higher for firms that optimally choose an accounting expert relative to firms that choose any audit-committee candidate suboptimally.

These studies reflect the view that accounting experts on an audit committee is important in constraining the propensity of managers to engage in earnings management/manipulation, and therefore, contributing to higher reporting quality. Similar to these prior studies and the SEC initial definition, this study defines accounting experts as those with a CPA or experience in corporate accounting (i.e., chief financial officer, treasurer, controller or vice-president of finance). Because accounting experts have extensive knowledge and experience about how to accurately maintain books/records and achieve effective internal control, having accounting experts on an audit committee is expected to help reduce the likelihood of FCPA violation that involves improper record-keeping and ineffective internal control.

7. Gender Diversity of Top Management

The gender socialization approach per Kohlberg (1984) posits that men and women have distinctively different values and traits, thereby creating different moral orientations that result in different decisions and practices. Men tend to seek competitive success and are more likely to break rules whereas women are more likely to adhere to rules because they are concerned about having harmonious relationships. This research suggests that a company with more female executives may have a lower likelihood of FCPA violation. The negative relation between gender diversity and FCPA-violation likelihood is supported via firm performance by the following empirical evidences. Adler (2001), Catalyst (2004) and Nakagawa and Schreiber (2014) document a strong and positive correlation between gender diversity and firm performance/profitability. Darrough (2010) and Burnham et al. (2018) then find that companies with poorer profitability are more likely to violate the FCPA. Barua et al. (2010) also find that companies with female CFOs have higher-quality accruals and lower absolute accrual estimation errors than companies with male CFOs. Krishnan and Parsons (2008) show that earnings quality is positively associated with gender diversity in senior management. Velte (2016) finds that female members in the management board do have a positive impact on environmental, social and governance performance among German and Austrian companies. Based on these findings, companies with more female executives are expected to perform better in compliance, hence less likely to violate the FCPA.

Control Variable-Profitability

This study includes profitability measured by return on assets as a control variable because Darrough (2010) finds poor performance among his 43 FCPA violators, and several earlier studies also posit that managers of a poorer-performing firm likely face higher pressure to show improving financial results than a better-performing one. Maksimovic and Titman (1991) argue that the reputation costs to engage in questionable conduct tend to be lower for poor-performing firms than financially healthy firms. Likewise, Daboub, et al. (1995) suggest organizational performance as a contributing factor to corporate illegal activity. Kellogg and Kellogg (1991) also state that poor performance provides incentive for managers to engage in fraudulent activities because poor performance adversely affects managers' job security and compensation. The desire to strengthen their job security could make managers of a poor-performing firm succumb to the demand for bribery from foreign officials in emerging economies in exchange for government contracts, licenses or permits. Ang et al. (2016) find that companies that gain listing via reverse mergers are more likely to commit fraud, and many small companies with a short operating history and poor performance tend to use this avenue to gain listing. Burnham et al. (2018) examine FCPA violations cases, and find that poorer performance increases the likelihood of illegal bribery because it puts greater pressure on managers to "make do with what they have," creating an environment in which illegal behavior such as bribery may be seen as the only viable alternative to achieve sales targets. FCPA violating firms are, therefore, expected to have a significantly worse profitability (return on assets) than their matched firms.

Data Collection

To enhance data availability, this study focused on publicly listed companies and used the SEC website to identify 143 firms that were subject to the FCPA enforcement by the SEC between January 1996 and December 2016. Starting in 1996, the SEC provided details about FCPA violation including country/circumstance of bribery, and the year in which bribery started and ended. Most bribery was to secure contracts from foreign governments in emerging economies in Asia, South America, Middle East region and Africa. Enforcement cases before 1996 were not usable because the SEC did not provide any details other than the name of alleged violators. However, the SEC took actions against only six violating companies between the FCPA enactment in 1977 and the end of 1995.

Top six SEC-settlement years were 2016 with 24 firms, 2010 with 20 firms, 2007 with 14 firms, 2011 with 13 firms, 2009 with nine firms and 2012 with nine firms. This evidence suggests that the FCPA enforcement has received much more emphasis from the SEC since 2007. Top five bribery starting years were 2000—18 firms, 2001—16 firms, 2002—12 firms, 2003—11 firms and 2005—11 firms. An average duration of FCPA violation (bribery period) lasted close to five years. It took the SEC an average of three to four years from a bribery ending year to conclude its investigation and reached a settlement with the firms. About two-thirds of firms self-reported the FCPA violation to and fully cooperated with the SEC so as to obtain more lenient settlement.

These 143 violators are required to have financial and corporate governance data for the first year of bribery. Eighteen of them do not have the data and the final sample is reduced to 125 FCPA violators. These violators came from 74 different industries based upon the four-digit Standard-Industrial-Classification (SIC) code. The top two industries with the highest concentration of FCPA violators are 2834-Pharmaceutical Preparation (13 firms) and 1381-Drilling Oil and Gas Wells (seven firms). Seventy-one percent of the 125 violators are U.S. firms, and the other 29 percent are foreign firms from Europe except three firms from South America (Brazil and Chile), two firms from Bermuda, two firms from Asia (Japan and Israel), and one firm from Canada. Top four countries of European FCPA violators are the U.K. (six firms), France (four firms), Germany (four firms), and Netherlands (three firms).

This study identified a matched (control) firm for each violator using the following criteria: (1) a control firm has not been alleged by the SEC between 1977 and 2016 of violating the FCPA; (2) it is in the same industry (based on the SIC code) as the violator; (3) it had a similar size (net sales closest to the FCPA violator) for the first year of bribery; and (4) it had financial and corporate governance data for the same data-collection period as the matched violator. Industry and size are important matching criteria as they can potentially affect corporate governance per Daboub, et al. (1995) who explain that: (1) opportunity for wrongdoing may vary across industries due to the differential industry-specific environment; (2) size is a proxy for complexity which likely impacts governance; and (3) larger firms are more likely to be scrutinized by regulators and the public due to their size (visibility). This study also tried to identify a matched firm that comes from the same home country or geographical region as an FCPA violator.

This study used the SEC's online EDGAR database to obtain financial and corporate governance data. Financial data of violators and matched firms came from their annual reports (Form 10-K for U.S. firms and Form 20-F for foreign firms) for the first year of bribery. Corporate governance data of violators and matched firms for the first year of bribery were collected from proxy statements of U.S. firms and Form 20-F of foreign firms. The final sample comprises of 125 violators and 125 matched non-violators. These 125 violators had engaged in an average amount of $24 million in bribery that resulted in an average amount of $31 million in illicit profit and an average amount of $60 million in penalty.

Methodology

The study used both univariate statistics (t-test and Wilcoxon rank-sum test) and a conditional (fixed–effects) logit regression to analyze the seven corporate governance characteristics of the FCPA violating firms and the matched firms. Cram and Karan (2009) indicate that conditional logit regression is more appropriate than unconditional one for choice-based and matched-sample studies such as this study because of the following two reasons. First, conditional logit takes pairing into account by finding effects that are conditional on industry and size which are the matching criteria used in this study and many other matched-sample studies. A within-group effect may not be found if the data are pooled as in an unconditional analysis. Second, conditional logit regression produces unbiased coefficients of the explanatory variables when matched samples are nonrandom or when the number of observations in the sample outcome groups and matched sets are not proportional to the sizes of the corresponding groups in the general population. That is 50 percent of sample firms in this study are FCPA violators and the other 50 percent are non-violators whereas the true rate of FCPA violation in the population of publicly listed firms is likely to be much less than 50 percent. Maddala (1991) also states that the coefficients of the explanatory variables in conditional logit are not affected by the disproportionate sampling rates from the two groups, and that only the constant term is affected. Correcting for the bias in the constant term is necessary only if the purpose is to develop a predictive model (Palepu, 1986). Since this study's purpose is not to develop a predictive model of FCPA-violation likelihood, bias in the constant term has no effect on the analysis and the conditional logit regression below is appropriate for testing the hypotheses.

$$\begin{aligned} FCPA = \; & a + b_1 CEOCHR + b_2 CEOTEN + b_3 GCTEN + b_4 BODIND + b_5 AUDMET \\ & + b_6 AUDACC + b_7 FEMMGT + b_8 ROA \end{aligned}$$

FCPA = 1 if a firm violated the FCPA and 0 otherwise.
CEOCHR = 1 if CEO is also the BOD chairman and 0 otherwise.
CEOTEN = Tenure of CEO.
GCTEN = Tenure of general (legal) counsel.
BODIND = Percentage of independent directors on the BOD.
FEMMGT = Percentage of female top executives.
AUDMET = Audit-committee meeting frequency in a year.
AUDACC = Percentage of audit-committee members with accounting expertise.
ROA = Return on assets computed as net income divided by average total assets.

All explanatory variables are measured as of the first year of bribery. All of them are expected to be negatively related to the likelihood of FCPA violation, except CEOCHR that could have either a positive or a negative relationship with the FCPA-violation likelihood.

Results

Table 1 reports univariate tests on financial characteristics of 125 FCPA violators and 125 matched non-violators. The t-test is for testing the difference in mean, and the Wilcoxon rank-sum test is for testing if the two groups are from population with the same distribution. Both univariate methods test each of these variables separately from one another. Both tests indicate no significant difference between the FCPA violators and their matched non-violators with respect to net income, net sales, total assets, operating cash flows and foreign sales. These insignificant results confirm that the selected non-violators are good matches with the violators in terms of their overall firm size and the size of their foreign operations. The two groups also have comparable capital structure, i.e., no significant difference in terms of how much they used debt to finance asset acquisition as measured by total liabilities to total assets. Regardless of the similar size and similar capital structure, FCPA violators' profitability ratios are significantly lower than those of their matched competitors. In particular, both the mean profit margin and the mean return on assets of violators are about 6 percent vs. 9 percent of their matched peers. This weaker profitability could pressure management to engage in bribery to improve the financial performance. This result supports the inclusion of a profitability ratio as a control variable in the regression. [see Table 1, pg 158]

Table 2 reports univariate tests on the seven corporate governance variables, all of which are statistically significant, and are listed in the order of their significance as follows: AUDMET, BODIND, GCTEN, AUDACC, FEMMGT, CEOTEN and CEOCHAIR. These results suggest that an audit committee of violators meets less frequently with the median of five times for violators and seven times for matched firms. Additionally, FCPA violators have a less independent BOD—with 72.23 percent of their board members are independent vs. 78.65 percent of matched firms' board members are independent. FCPA violators also tend to have the general counsel with a shorter tenure of about three years on average versus five years average tenure of matched competitors' legal counsel. Additionally, violators had fewer audit committee members who are accounting experts with the median of 0 percent for violators and 20 percent for non-violators. Although both groups had very few female executives with the median of 0 percent, non-violators had a significantly higher mean of 9.40 percent compared to 5.82 percent for violators. FCPA violators' CEO also had a shorter tenure (median of three years) than matched peers' CEO (median of five years). Lastly, FCPA violators tend to have less CEO duality, i.e., 52.2 percent of FCPA violators vs. 63.4 percent of non-violators have the same person as CEO and BOD chairman. Although this CEO-duality result has only 10 percent significance level. [see Table 2, pg 159]

Table 3 presents results of the conditional logit regression analysis which jointly accounts for the effect of all seven corporate governance variables at the same time. The results indicate that six out of seven variables have a significantly negative relationship with the FCPA violation. Listed in the order of significance level, they are AUDMET, BODIND, GCTEN, FEMMGT, CEOTEN and AUDACC. These results are consistent with the expectation and the results of univariate tests. In sum, FCPA violators tended to have fewer audit-committee meetings, less BOD independence, a shorter-tenure legal counsel, fewer female executives, a shorter-tenure chief executive officer, and a lower percentage of audit-committee accounting experts. CEOCHR is the only corporate governance variable that is not significantly related to FCPA violation per the conditional logit analysis. Result concerning the control variable, ROA, suggests that FCPA violators were significantly less profitable than their control firms, supporting the argument that poor profitability provided motivation for bribery to secure more revenue to improve profit. [see Table 3, pg 160]

Robustness Tests

Because the first year of bribery (FCPA violation) among the sample firms spans 30 years from 1983 through 2013, it is necessary to examine the impact of major changes in corporate governance landscape introduced by the Sarbanes-Oxley Act (SOX) of 2002. SOX directly impacts two independent variables: AUDACC and BODIND. Per SOX, every listed company is required to disclose whether or not: (1) it has at least one financial expert serving on its audit committee, and (2) its audit committee is independent from its top management. Although these disclosure requirements strongly motivate all listed companies to have an independent audit committee with at least one financial expert, it is likely that high-integrity companies that do not violate the FCPA would want to signal its high integrity to the public by having: (1) at least one "accounting" expert (a more stringent criterion than just a financial expert), and (2) more independent directors serving not only on its audit committee but also on other BOD committees. This study, therefore, expects AUDACC and BODIND to have a more significantly negative coefficient during the post-SOX period (since 2002) than during the pre-SOX period.

Table 4 presents results of the conditional logit regression analysis during the pre-SOX period with 55 FCPA violators and 55 matched non-violators. Six variables with a significantly negative coefficient (in the order of significance level) are AUDMET, CEOTEN, GCTEN, BODIND, FEMMGT and ROA. This result means that, during the pre-SOX period, FCPA-violation likelihood is related to fewer audit-committee meetings, shorter CEO tenure, shorter general-counsel tenure, less independent BOD, fewer female top executives and less profitability. [see Table 4, pg 161]

Table 5 reports results of the conditional logit regression analysis during the post-SOX period with 70 FCPA violators and 70 matched non-violators. Six variables with a significantly negative coefficient (in the order of significance level) are BODIND, AUDMET, FEMMGT, GCTEN, ACCAUD and ROA. As expected, there are two major differences between post-SOX and pre-SOX results. First, BODIND is more statistically significant during the post-SOX period (0.5 percent level) than the pre-SOX period (5 percent level). Second, ACCAUD becomes statistically significant during the post-SOX period whereas it is not at all significant during the pre-SOX period. So, the significant result of ACCAUD in the full sample is driven by the post-SOX sample. The increased statistical significance of BODIND and ACCAUD highlights the positive impact of SOX's corporate governance emphasis on FCPA compliance. Another noteworthy result, that CEOTEN is no longer significant during the post-SOX period, seems to imply that the SOX may have dampened the aggressive risk-taking of short-tenure CEO because the SOX has greatly increased corporate oversight and penalty for executive wrong-doing. [see Table 5, pg 162]

This study also performed the following robustness tests. First, it examined correlations of the eight explanatory variables to check for multicollinearity problem that may affect the regression results. All correlations are below 0.25, suggesting that multicollinearity is not a problem. Second, an alternative measure of profitability, profit margin, was used in place of return on assets. The inferences of logit regression analysis with profit margin are virtually the same as those reported earlier. Third, board size, audit committee size, CEO age and CEO education (MBA or not) are included as independent variables in the regression analysis. These additional variables are not significant and the inferences regarding other variables remain virtually the same.

Conclusions and Implications

This study investigates the relation between the likelihood of FCPA violation and seven corporate governance characteristics. The results based upon conditional logit regression analysis indicate that the likelihood of FCPA violation is higher when: (1) audit committee meets less frequently; (2) board of director is less independent; (3) general counsel has a shorter tenure; (4) there are fewer female executives; (5) CEO has shorter tenure; and (6) fewer audit-committee members have accounting expertise. CEO duality is not related to FCPA-violation likelihood. Additional analysis reveals a stronger negative relationship between FCPA-violation likelihood and: (1) BOD independence, and (2) audit-committee members with accounting expertise during the post-SOX period than the pre-SOX period. These results highlight the positive impact of SOX's emphasis on BOD independence and audit committee expertise on FCPA compliance.

Therefore, to reduce the FCPA-violation likelihood, companies may want to improve their corporate governance by: (1) encouraging audit committee to meet more frequently to provide better oversight over financial reporting and internal control; (2) increasing the number of independent directors; (3) retaining legal counsel to serve for a long time so as to gain more firm-specific expertise; (4) recruiting more female executives; (5) being vigilant in monitoring a shorter-tenure CEO; and (6) recruiting more accounting experts to serve on an audit committee. To cope with poor profitability as a motivator for bribery, companies may want to use a broad-based performance evaluation approach such as the balanced scorecard that also emphasizes nonfinancial aspects such as customers, internal process, and learning and growth of employees.

Regulators could also use this study's findings to identify potential FCPA violators by targeting firms without a general/legal counsel. Additionally, the SEC and the DOJ could incorporate this study's findings/suggestions into their remedial demand for corporate-governance improvement of FCPA violators that settle or lose a legal battle with the regulators.

This study also has a direct implication for investors, i.e., they may want to avoid firms that have no general counsel and no "accounting" expert on the audit committee that meets infrequently. In all, this study contributes to the literature on corporate governance role against FCPA violation by highlighting the importance of audit-committee meeting frequency, accounting experts on audit committee, BOD independence, female executives, and especially general counsel tenure (a proxy for firm-specific legal expertise) that has not been examined by prior accounting and finance studies involving regulation and corporate compliance/governance. It also points out the positive impact of SOX's corporate governance on FCPA compliance.

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Table 1: Univariate Tests on Financial Characteristics of FCPA Violators vs Matched Firms

(in millions except TLTA, MARGIN and ROA that are in %)

Variables	Minimum	Mean	Median	Maximum	T-Test	Wilcoxon
Net Income						
FCPA	-8,101	1,187	212	13,416		
Matched	-1,056	1,256	227	16,465	-0.2018	-0.942
Net Sales						
FCPA	24	14,778	2,916	137,943		
Matched	47	14,072	2,916	209,417	0.2080	0.268
Total Assets						
FCPA	21	33,621	3,562	1,198,942		
Matched	28	30,383	3,780	1,269,892	0.2113	0.382
Operating CF						
FCPA	-24,227	1,516	304	24,593		
Matched	-12,223	1,870	320	27,634	-0.6283	-0.463
Foreign Sales						
FCPA	9.49	6,797	1,557	70,302		
Matched	7.79	6,599	1,377	145,814	0.1060	0.677
TLTA%						
FCPA	8.07	57.40	57.12	170.57		
Matched	7.49	54.20	53.25	124.62	1.1581	1.175
MARGIN%						
FCPA	-54.42	6.56	6.41	58.46		
Matched	-39.43	9.16	7.52	51.27	-1.9180**	-1.737**
ROA%						
FCPA	-19.50	6.21	5.74	33.72		
Matched	-32.85	8.65	7.36	76.18	-2.0821**	-1.832**

There are 125 FCPA violators and 125 matched non-violators. TLTA = Total liabilities divided by total assets. MARGIN (Profit Margin) = Net income divided by net sales. ROA (return on assets) = Net income divided by average total assets. These three ratios are for the year preceding the first year of FCPA violation.

** Statistically significant at $p < 0.05$.

Table 2: Univariate Tests on Corporate Governance of FCPA Violators vs. Matched Firms

Variables	Minimum	Mean	Median	Maximum	T-Test	Wilcoxon
CEOCHR						
FCPA	0	0.522	1	1		
Matched	0	0.634	1	1	-1.861*	-1.852*
CEOTEN						
FCPA	0	6.045	3	38		
Matched	0	7.496	5	39	-1.697**	-2.146**
GCTEN						
FCPA	0	3.183	2	21		
Matched	0	5.179	4	27	-3.449****	-2.780***
FEMMGT						
FCPA	0%	5.82%	0%	26.73%		
Matched	0%	9.40%	0%	45.08%	-2.648***	-1.730**
BODIND						
FCPA	9.09%	72.23%	77.35%	100%		
Matched	33.33%	78.65%	81.81%	100%	-3.287***	-3.169***
AUDMET						
FCPA	1	5.851	5	13		
Matched	2	7.142	7	13	-4.006*****	-3.979*****
AUDACC						
FCPA	0%	13.63%	0%	75%		
Matched	0%	20.40%	20%	100%	-2.593***	-1.849**

There are 125 FCPA violators and 125 matched non-violators. CEOCHR = 1 if CEO is also the BOD chairman and 0 otherwise. CEOTEN = Tenure of CEO up to the first year of FCPA violation. GCTEN = Tenure of General Counsel up to the first year of FCPA violation. BODIND = Percentage of independent directors on the BOD. FEMMGT = Percentage of female top executives. AUDMET = Number of audit-committee meetings in a year. AUDACC = Percentage of audit committee members with accounting expertise. *, **, ***, ****, ***** represent statistically significance at the one-tailed 10%, 5% 1%, 0.1% and 0.01% level, respectively, except CEOCHAIR where the significance is at the two-tailed level.

Table 3: Conditional Logit Regression Results for Characteristics of FCPA Violators—Full Sample

Variables	Expected Sign	Est. Coeff.	Std. Error	Z-Statistic	Prob. > Z
CEOCHR	-/+	-0.134	0.411	-0.33	0.743
CEOTEN	-	-0.050	0.029	-1.71	0.044**
GCTEN	-	-0.118	0.044	-2.67	0.004***
BODIND	-	-3.541	1.297	-2.73	0.003***
AUDMET	-	-0.254	0.090	-2.83	0.003***
AUDACC	-	-1.613	0.947	-1.70	0.044**
FEMMGT	-	-0.389	0.171	-2.27	0.012**
ROA	-	-5.427	2.501	-2.17	0.015**
Chi-Square		59.41			
Probability Level		0.0000*****			

There are 125 FCPA violators and 125 matched non-violators. ROA = Return on average total assets for the year preceding the first year of FCPA violation. CEOCHR = 1 if CEO is also the BOD chairman and 0 otherwise. CEOTEN = Tenure of CEO up to the first year of FCPA violation. GCTEN = Tenure of General (Legal) Counsel up to the first year of FCPA violation. FEMMGT = Percentage of female top executives. BODIND = Percentage of independent directors on the BOD. AUDMET = Number of audit-committee meetings in a year. AUDACC = Percentage of audit committee members with accounting expertise.
*, **, ***, ****, ***** represent statistically significance at the one-tailed 10%, 5% 1%, 0.1% and 0.01% level, respectively.

Table 4: Conditional Logit Regression Results for Characteristics of FCPA Violators—PRE-SOX

Variables	Expected Sign	Est. Coeff.	Std. Error	Z-Statistic	Prob. > Z
CEOCHR	-/+	-0.725	0.729	-0.99	0.320
CEOTEN	-	-0.128	0.059	-2.18	0.015**
GCTEN	-	-0.154	0.081	-1.89	0.030**
BODIND	-	-4.450	2.554	-1.74	0.041**
AUDMET	-	-0.423	0.183	-2.31	0.010***
AUDACC	-	-0.916	1.704	-0.54	0.296
FEMMGT	-	-0.454	0.279	-1.63	0.052*
ROA	-	-7.649	4.740	-1.61	0.054*
Chi-Square		33.01			
Probability Level		0.0001*****			

There are 55 FCPA violators and 55 matched non-violators during the pre-SOX period (before 2002). ROA = Return on average total assets for the year preceding the first year of FCPA violation. CEOCHR = 1 if CEO is also the BOD chairman and 0 otherwise. CEOTEN = Tenure of CEO up to the first year of FCPA violation. GCTEN = Tenure of General (Legal) Counsel up to the first year of FCPA violation. FEMMGT = Percentage of female top executives. BODIND = Percentage of independent directors on the BOD. AUDMET = Number of audit-committee meetings in a year. AUDACC = Percentage of audit committee members with accounting expertise.

*, **, ***, ****, ***** represent statistically significance at the one-tailed 10%, 5% 1%, 0.1% and 0.01% level, respectively.

Table 5: Conditional Logit Regression Results for Characteristics of FCPA Violators—POST-SOX

Variables	Expected Sign	Est. Coeff.	Std. Error	Z-Statistic	Prob. > Z
CEOCHR	-/+	0.644	0.629	1.02	0.306
CEOTEN	-	-0.007	0.040	-0.19	0.427
GCTEN	-	-0.087	0.053	-1.69	0.048**
BODIND	-	-5.522	2.156	-2.56	0.005***
AUDMET	-	-0.343	0.114	-2.35	0.01***
AUDACC	-	-1.809	0.875	-1.66	0.050**
FEMMGT	-	-0.562	0.313	-1.79	0.037**
ROA	-	-4.159	3.110	-1.34	0.090*
Chi-Square		39.05			
Probability Level		0.0000*****			

There are 70 FCPA violators and 70 matched non-violators during the post-SOX period (2002 and after). ROA = Return on average total assets for the year preceding the first year of FCPA violation. CEOCHR = 1 if CEO is also the BOD chairman and 0 otherwise. CEOTEN = Tenure of CEO up to the first year of FCPA violation. GCTEN = Tenure of General (Legal) Counsel up to the first year of FCPA violation. FEMMGT = Percentage of female top executives. BODIND = Percentage of independent directors on the BOD. AUDMET = Number of audit-committee meetings in a year. AUDACC = Percentage of audit committee members with accounting expertise.

*, **, ***, ****, ***** represent statistically significance at the one-tailed 10%, 5% 1%, 0.1% and 0.01% level, respectively.