The Morning Risk Report: Petrobras Underlines Corruption Risks for Investors

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U.S. authorities have long argued that foreign bribery is a sign of deeper rot at a company that can sting investors. But many U.S.-based Foreign Corrupt Practices Act cases have not caused lasting damage to companies, even those that pleaded guilty to widespread bribery.

But the widening scandal at Brazil's state-controlled energy company Petrobras is illustrating just how hard investors can be hit when corruption is alleged to be endemic at a firm. The allegations have helped push its stock price down more than 60% since September and led to the ouster of its chief executive last month. The scandal also caused Moody's to reduce the company's debt to junk status. But that could be just the start. Anger over the revelations sent more than a million Brazilian protesters into the streets last weekend, in a sign that the issues may lead to a broader, more painful reorganization of the firm, said Stephen Davis, an associate director of Harvard Law School's program on corporate governance. "It has elevated corruption on the risk hierarchy within the investor community," Mr. Davis said. The case begs the question "if a company is looking the other way or tolerating corruption what else is the company doing that might not be in the shareholders' interest?"

Institutional investors are taking a particularly hard look at state-run enterprises, Mr. Davis said. The pileon of media, protesters and Brazilian authorities has had a particularly crippling effect on Petrobras, Mr. Davis said. But it's a scenario that the explosion of social media has made increasingly likely. "It has become impossible for anything to be kept secret now," he said. Petrobras executives have said the company is the victim of kickback schemes and is cooperating with authorities