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A Review of Frauds inside Conglomerates:
The cases of Keiretsu and Chaebol



UNIVERSIDADE DO ALGARVE
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A Review of Frauds inside Conglomerates:

The cases of Keiretsu and Chaebol

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Abstract

This dissertation systematically reviews the relevant literature concerning corporate frauds in Japanese and South Korean conglomerates. At a more detailed level, it analyzes the market reaction and how governments manage to diminish the incidence of these fraudulent acts by compiling and discussing the primary studies and identifying existing gaps to investigate at a doctoral level.

This study uses the Systematic Literature Review as methodology as it prevents the author's beliefs from interfering with the results obtained. Articles of several strands within the fraud theme were identified. The results show that the comprehensive understanding of this topic is recent given the significant increase in the incidence of fraud in companies that may be due to the tremendous pressure to remain competitive and relevant in the market. As such, there are several research opportunities to be explored in future investigations.

In this sense, the collected evidence points out that the market is only affected by the fraudulent acts of a company according to how the culture perceives it, emphasizing that this variable is crucial for future studies. In addition, the relationship between fraud and the corporate governance of the conglomerate that influences how the business is organized (e.g., hierarchization and the incentives and opportunities that the executives perceive) is crucial to understand the fraud phenomenon. However, some studies show a tendency to decrease the incidence of fraud in the countries studied and a dependence on the elasticity of the variables involved.

Keywords: Corporate Fraud; Financial Fraud; Corporate Crime; Japanese Conglomerate; Korean Conglomerate

Resumo em Português

Esta dissertação revê de forma sistemática a literatura relevante sobre fraudes em conglomerados do Japão e da Coreia do Sul com o objetivo de compilar e discutir os principais estudos e identificar lacunas existentes para posterior desenvolvimento de uma investigação a nível de doutoramento.

A primeira parte deste trabalho aborda todos os conceitos que são utilizados ao longo de toda a pesquisa com o objetivo de ambientar o leitor ao tema e facilitar a sua compreensão. É exemplificado o termo conglomerado com as peculiaridades de cada um abordado, os *Keiretsu* e dos *Chaebol*. São também discutidas as principais teorias académicas que buscam compreender as fraudes, como por exemplo a Teoria do Triângulo da Fraude criada por Cressey (1953) e a Teoria do Diamante da Fraude, de Wolfe & Hermanson (2004), sendo as precursoras de todas as outras teorias criadas posteriormente.

O principal objetivo desta dissertação consiste no estudo da relação entre conglomerados e fraudes através da análise das reações que os mercados e os respetivos governos, japonês e coreano, apresentam para diminuir a incidência desses atos fraudulentos. A Revisão Sistemática da Literatura é utilizada como metodologia para identificar o conjunto de estudos relevantes e identificar as principais lacunas de investigação uma vez que permite alcançar este desígnio prevenindo que as crenças do autor interfiram nos resultados obtidos. A primeira parte do processo passou pela identificação de artigos científicos relevantes através da construção da cadeia de pesquisa por meio da seleção de palavras-chave relacionadas com o tema. Este conjunto de artigos foi posteriormente submetido à critérios rigorosos de exclusão e inclusão, nesta ordem, para obtermos um conjunto de 12 artigos identificados neste processo. A amostra final é composta por 15 artigos, uma vez que foram adicionados 3 artigos relevantes fora da cadeia de pesquisa e que se enquadram nos critérios de exclusão e inclusão.

Os 15 estudos foram analisados de forma detalhada e integrada e estão na base das principais conclusões desta dissertação bem como das oportunidades de investigação identificadas. A análise destes estudos permite concluir que a literatura académica não apresenta uma definição unânime de fraude, pois os trabalhos analisados tendem a ajustar a sua definição com base nos seus objetivos de pesquisa. Neste contexto, foi identificado dois tipos de fraudes mais estudadas pelos académicos: fraudes cometidas por contabilistas certificados, geralmente relacionados com a aprovação dos relatórios

financeiros que contêm erros ou manipulação dos resultados e estão diretamente ligadas a cultura local e como é mantida as relações interpessoais; e as fraudes contabilísticas que utilizam de métodos específicos ou brechas nos métodos contabilísticos para sobrevalorizar as empresas. E, muitos dos casos, visam evitar a falência, esconder perdas, enriquecimento próprio ou aumentar a influência do CEO nas empresas filiais.

Após a descoberta das fraudes cometidas, as empresas devem lidar com as consequências. O mercado tende a reagir de forma negativa aos casos e todas as empresas no mercado acabam por perder valor, aumentando as comparações com os mercados ocidentais. E, conforme os seus dados, o mercado pode não levar a perda indireta de reputação tão a sério quanto leva a perda financeira direta do crime de colarinho branco e pode considerar os crimes de rua cometidos pelos executivos como assuntos pessoais. Além de adotarem uma postura de preventiva contra a reação do mercado e mudarem de auditor quando a qualidade é questionada.

Adicionalmente, notou-se que a estrutura da empresa influencia diretamente as fraudes. Como os conglomerados são centralizados numa única empresa, permite um maior controlo das transações internas e manipulações para benefícios próprios dos executivos. A estrutura da gestão corporativa que apresenta um fraco controlo interno também pode influenciar nas oportunidades de fraude, assim como a presença de bancos nos conglomerados japoneses, embora tenha uma maior monitorização, aumenta os incentivos de fraude com a pressão de atingir certos objetivos. Também se verifica que existe uma tendência por parte dos executivos, que para esconder fraudes dos acionistas, realizam as reuniões anuais em datas populares para evitar a presença dos mesmos.

Alguns mecanismos foram criados com a intenção de evitar fraudes nas empresas, como a criação de legislações por parte dos governos, mas é enfatizada a necessidade da criação de uma única lei que englobe todos os tipos de fraude, evitando possíveis brechas. Ainda, foi implementado a política de rotação da auditoria para tentar garantir a alta qualidade, porém após dez anos deixou de ser obrigatória por não apresentar resultados satisfatórios e a solução foi adotar as normas internacionais de relatório financeiro.

Por fim, a respeito das perspetivas futuras de fraude, há um otimismo para a redução dos índices de fraudes após o período pandémico, mas importante salientar que a cultura local é um importante fator a ser considerado na ocorrência de fraudes e nas suas perspetivas futuras.

Ao analisar os resultados obtidos foi observado que apesar de ter estudos datados da metade do século passado que originaram as teorias utilizadas nas investigações atuais,

apenas recentemente este tema deixou de ser estudado unicamente no âmbito teórico e passou a ter mais ênfase nos estudos empíricos, provavelmente também por um aumento significativo da incidência de fraudes nas empresas que podem se dar devido à grande pressão de continuarem competitivas e relevantes no mercado, abrindo margem para muitas oportunidades a serem exploradas em investigações futuras. Neste sentido, as evidências coletadas apontam que o mercado só é afetado pelos atos fraudulentos de uma empresa consoante como a cultura o percebe, ou seja, existem atos que em alguns países e mercados são considerados fraudulentos enquanto em outros não, o que demonstra que a cultura é uma variável extremamente relevante e deve ser incluída em futuros estudos desenvolvidos. Outra perspectiva apontada é a relação entre a fraude e o conglomerado vista através da sua gestão corporativa que influencia na forma como o negócio é organizado, incluindo na sua hierarquização e nos incentivos e oportunidades que os executivos percebem dentro dos conglomerados que os levam a cometerem fraude. E, por último, é destacado a importância de reproduzir alguns dos estudos da amostra, visto que houve implementações de novos regulamentos e leis, tanto no Japão quanto na Coreia do Sul, que podem alterar os resultados e, até mesmo, modificar as conclusões dos autores, assim a nossa compreensão a respeito do tema em questão também é alterada, levando-nos a desenvolver e expandir cada vez mais o conhecimento acadêmico acerca das fraudes no ambiente corporativo.

Palavras-chave: Fraude Empresarial; Fraude Financeira; Crime Empresarial; Conglomerado Japonês; Conglomerado Coreano

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Abbreviation List

AGMs	Annual General Meetings
B-ON	Online Knowledge Library
CEO	Chief Executive Officer
CG	Corporate Governance
CPAs	Certified Public Accountants
DSME	Daewoo Shipbuilding & Marine Engineering
FTT	Fraud Triangle Theory
FDT	Fraud Diamond Theory
IFRS	International Financial Reporting Standards
J-SOX	Japanese Sarane-Oxley Act
MICE	Money, ideology, Coercion, and Ego Theory
NPA	National Police Agency
PPO	Public Prosecutions Office
PwC	PricewaterhouseCoopers
ROA	Return on Assets
SEC	Security Exchange Committee
SLR	Systematic Literature Review
SPEs	Special-Purpose Entities

1. Introduction

In 1760, England saw a change in the social and economic structure, considered unique for the time, which pointed to the first step towards capitalism and the development of the market to the current molds. This new industrial structure spread to the United States, Japan, Germany, and France in the last half of the 19th century. It took place in the so-called II Industrial Revolution, in which financial capitalism was initiated with the expansion of trade to international levels. With this, the companies recognized that they should improve their production techniques to become more competitive in the market in order to increase their income. After the World War II, in the mid-20th century, the III Industrial Revolution began, where the industrialization we know today spread worldwide through globalization and strengthened financial capitalism. In this last revolution, companies that were already seeking the most outstanding profitability realized that the market competitiveness was great. Their prospects were considerably low if they did not resort to high investments to keep up with the market. In this context conglomerates emerged. Generally speaking, conglomerates represent a set of several companies that operate often in different sectors that come together since their share common goals. Conglomerates are thus a solution for companies to survive in an unstable environment that requires constant change.

Although an interesting solution for businesses to compete in a demanding market, recent years witnessed a high incidence of fraud cases in conglomerates, mainly in Japan and South Korea. Despite the significant impact in the market and society, fraud is still an extensive and generic term (Albrecht, Albrecht, Albrecht, & Zimelman, 2014). In the academic sphere, studies define fraud accordingly to the peculiarities of his/her research. Yet, three general types of fraud are generally considered: financial statement fraud (Demetriades & Owusu-Agyei, 2021), misappropriation of assets and corruption (Wells, 2007). Regardless of the definition, fraud typically includes accounting malpractices and the creation of illegal funds (Albrecht, Turnbull, Zhang, & Skousen, 2010), clearly breaching the trust of shareholders and the market as a whole (Barnett, 2000).

Cressey saw an opportunity to develop a study that seeks to understand the fraudulent behavior of executives, creating the Fraud Triangle Theory in 1953. Since then, several authors developed other fraud theories, given rise to the Fraud Diamond

Theory, the Fraud Scale, M.I.C.E. model, and the New Fraud Triangle Theory just to mention a few.

Corporate fraud practices by conglomerates are still ill-explored in the literature. Yet, the scant literature available clearly suggests that this situation is very harmful for the companies and their stakeholders, affecting the economy as a hole in many circumstances (Song & Han, 2017). As a result, this work intends to explore the relationship between fraud and the Japanese and Korean conglomerates. By using a Systematic Literature Review of the literature, this study seeks to identify the gaps in the theme to be explored at the doctoral level.

This dissertation is organized as follows. Besides this introductory chapter, chapter 2 summarizes the main ideas about the theories mentioned in the introduction and the conglomerates to be addressed. This is followed by chapter 3, describing the methodology used. Chapter 4 presents and discusses the results, and chapter 5 concludes.

2. Theoretical Framework

This chapter contextualizes the area of study and the most important issues that will be addressed in this work. In particular, it discusses the main issues related to Japanese and Korean conglomerates and the existing theories addressing fraud.

2.1. Conglomerates

A conglomerate is a rock that consists of small, rounded stones shaped by the force of water, which are held together by clay and sand but are formed only in some specific conditions (King, 2005). Similarly, business corporation conglomerates are formed by unrelated firms that are engaged to achieve joint projects and share technology that, otherwise, would be difficult to have (Jacoby, 1970), and, as the rock, they have a unique structure that unifies them.

Japanese (*Keiretsu*) and Korean (*Chaebol*) conglomerates stand out in the academic environment due to their management peculiarities (Minor, Patrick, & Wu, 1995). One of their characteristics is the possibility of making high-risk investments (Hong, Lee, & Lee, 2007), since the shareholders are likely to absorb part of the losses as they are directly linked to financial institutions (Minor, Patrick, & Wu, 1995). In addition, both conglomerates have adapted the style of Western companies, resulting in unique corporate governance systems (CG).

2.1.1. Keiretsu, the Japanese Conglomerates

The Japanese *keiretsu* is a family of several companies controlled by the same board of directors (Minor, Patrick, & Wu, 1995). The *keiretsu* is the *zaibatsu*'s decedent, which were groups based on the banking system that were disbanded after the Second World War (Minor, Patrick, & Wu, 1995). The *keiretsu* inherited specific characteristics of the *zaibatsu*. For instance, almost 80% of their shares are not publicly traded, which facilitates risk-taking strategies as their shareholders, primarily banks and financial institutions, will absorb the losses (Prowse, 1992). They are also characterized by a strong partnership between the business members. Usually, one company commands and partially finances the others (Jhonson III, 1992). This allows the development of long-term projects and reinforces the stability of the business environment and the possibility of exchanging technology and information.

Only in the 1950s, after the Second World War, the companies managed to regroup, mainly because of the government incentives, such as financial guarantees, protection from foreign competition, and direct subsidies (Cohen, 1985). In addition, when shares of the former *zaibatsu* were released on the stock market, the firms sought to control their management by seeking stable shareholders, leading to cross-shareholding. Although the *zaibatsu* holding companies were dismantled, their executives continued to meet informally. These meetings became a routine and evolved into presidents' councils (Minor, Patrick, & Wu, 1995). This is commonly related to why the Japanese market is more closed and not welcoming to the foreign investments (Uryu, Sunada, & Nakahashi, 1993).

The *keiretsu* can be divided into three types according to how they are centered (Minor, Patrick, & Wu, 1995):

- Horizontal or bank-centered: can work on long-time projects due to the financial support, and usually are very profitable as many competitors cannot risk those projects and cannot take advantage of those partnerships. It is only possible due to the Japanese bank system that keeps the stock market underdeveloped, forcing every firm to cultivate a strong partnership with a bank (Stefanadis, 1993).
- Vertical or supplier-centered: the manufacturers do an exclusive partnership with suppliers and tend to balance it with a lower transaction cost. For instance, major manufacturers, such as automobile makers or manufacturers of household electrical appliances, contract with suppliers for sole sourcing in exchange for production agreements excluding other buyers.
- Distribution-centered: usually focused on direct sales to chain stores under price maintenance contracts or sales through wholesalers.

2.1.2. Chaebol, the Korean Conglomerates

Chaebols are business groups with unique characteristics inherent to the Korean culture (Jwa & Lee, 2007), run by a family that controls the parent company that commands all the subsidiaries (Ungson, Steers, & Park, 1997). These features result in weak corporate governance systems, which leads to superior levels of agency problems (Hong, Lee, & Lee, 2007).

After a significant expansion of its business, which enabled it to control part of the country's economy, the Korean government has imposed laws to prevent monopolies,

forcing *chaebols* to choose only three sectors of activities to specialize in (Minor, Patrick, & Wu, 1995). Thus, the Korean conglomerates targeted the industries that require more investment in research and development and unique facilities, such as petrochemicals, automobiles, electronics, and heavy machinery. To meet those requirements, *chaebol* collaborates closely with securities firms to improve their money management. They are also getting around the Korean law by negotiating directly between member companies through the securities firms, including the global market. Importantly, as the *chaebols* are not allowed to get a commercial loan offshore, they appeal to domestic loans, leasing, and corporate bonds, that totalize almost 70% of debt-financed investment capital (Minor, Patrick, & Wu, 1995).

Compared with the *keiretsu*, *chaebols* are more centralized, hierarchical, family-controlled, and are more dependent on government relationships (Murillo & Sung, 2013). They also differ when, within the chaebol system, the company's members own each other's shares.

2.2. Corporate Frauds

Fraud is characterized by the abuse of power, responsibility, and the position held with the intention of self-enrichment and personal satisfaction instead of focusing on the company's good (Sutherland, 1943). The recent studies about corporate fraud focus on scandals that happened, and there is evidence that a failure in the corporate governance mechanism is linked to firm's loss (Merino & Manzanque, 2016). That can be explained with the help of Figure 2.1:

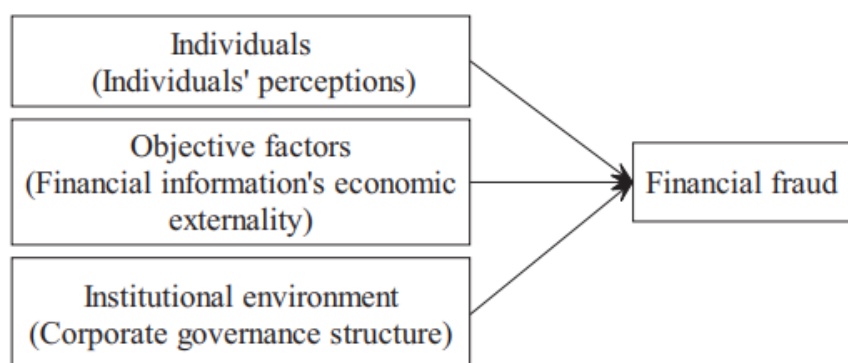


Figure 2.1 - Variables of Financial Fraud (Yang, Jiao, & Buckland, 2017)

People usually behave emotionally and thus tend to focus on the short-term consequences of their acts (Simon, 2013), which explains some cases of fraud caused by the top management's perceptions. Sometimes, these relate to manipulating financial

information (objective factor) to generate a false sense of excellent financial performance (Yang, Jiao, & Buckland, 2017). Yet, Corporate Governance aims to control managerial actions and decisions and is the only variable in Figure 2.1 that can be controlled (Yang, Jiao, & Buckland, 2017). In effect, there is evidence that board diversity and independence positively affect business performance by safeguarding the stakeholders' expectations (Thrikawala, Locke, & Reddy, 2016). However, several authors try to explain financial fraud through the perpetrator's behavior, which is hard for the company to control.

2.2.1. Fraud Triangle Theory

Donald R. Cressey, a specialist in sociology and criminology, in one of his studies, in 1953, proposed to investigate what leads people to commit corporate fraud and reached the conclusion that there are three factors (i.e., pressure, opportunities, and rationalization) that influence those behaviors, leading to the creation of the fraud triangle theory (FTT), as exposed on Figure 2.2:

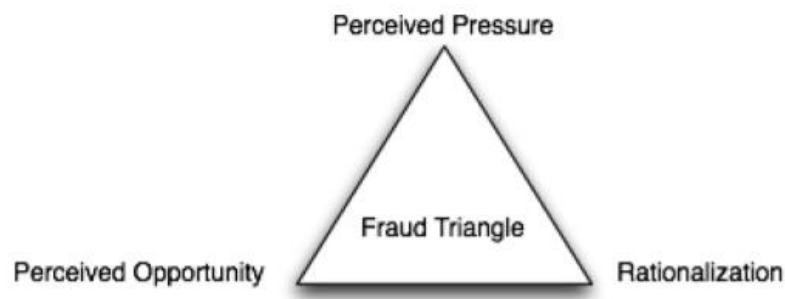


Figure 2.2 - Fraud Triangle (Cressey, 1953)

Perceived pressure may or may not be accurate. A person can still feel pressured without the intention of committing fraud. Pressure can manifest itself in many ways, like financial problems, a stressful work environment, external pressure, and political and social reasons (Murdock, 2008; Albrecht, Albrecht, & Albrecht, 2008). The second necessary element for fraud to occur is perceived opportunity. This is the feeling of having a chance to commit fraud, whether accurate or not, violating policies. This means the company has a control weakness in its system (Abdullahi & Mansor, 2015). Lastly, the rationalization element is characterized by the justification given by the employee for the fraud committed. It is the most abstract and imperceptible element, as it is related to everyone's ethics and way of thinking (Abdullahi & Mansor, 2015). Moreover, it can be considered the link between pressure and opportunity (Howe & Malgwi, 2006).

2.2.2. Fraud Scale

Based on Cressy's Fraud Triangle, Albrecht, Howe & Romney propose the Fraud Scale as an alternative theory in 1984. Albrecht, Howe & Romney (1984) consider three factors that lead to fraud: situational pressures, opportunity to commit fraud, and personal integrity as depicted in Figure 2.3:

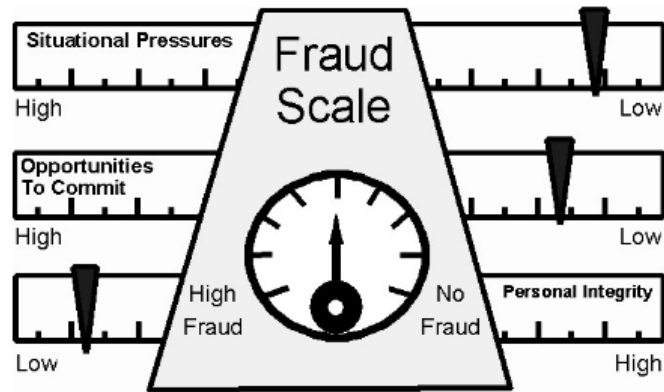


Figure 2.3 - Fraud Scale (Albrecht, Howe, & Romney, 1984)

Considering that rationalization is more abstract and complex for other people to understand, it was replaced with the variable personal integrity that can be weighted through the actions an individual has done in the past. As can be seen in Figure 2.3., those the three variables are interconnected. For example, if situational pressures and opportunities to commit fraud are low while personal integrity is high, there will be no fraud; if the opposite occurs, there will be a high chance of fraud.

2.2.3. Fraud Diamond Theory

In 2004, Wolfe & Hermanson published a paper on the Fraud Diamond Theory (FDT), in which they extended Cressey's theory by adding a new element: capability. The authors argue that, to commit fraud, it is not enough to have the opportunity, pressure, and rationalization; it is essential to be able to commit fraud. Therefore, Wolfe & Hermanson (2004), present a theory that defends four pillars for fraud, which are:

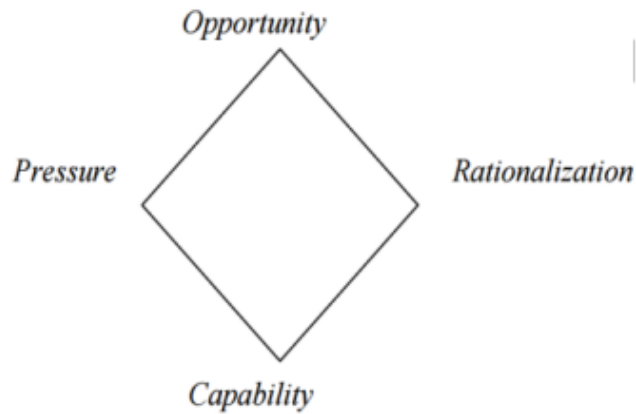


Figure 2.4 - Fraud Diamond Theory (Wolfe & Hermanson, 2004)

- The incentive, equivalent to Cressey's perceived pressure, fits the willingness or the perception that one should commit the fraud.
- Opportunity is the possibility of committing fraud when a gap in the system is observed.
- Rationalization is the phase when the person becomes convinced to carry out the fraud and that the risk is worth it.
- Finally, the capacity appears when, besides recognizing the opportunity and wanting to carry it out, one must have the skills to put it into practice.

According to the authors, in cases of fraud, some elements appear to have significant influence such as the position and function held in the company. For example, positions of authority have access to contracts, agreements, and accounting of the company, and they can take great advantage of eventual vulnerabilities (Wolfe & Hermanson, 2004). Interestingly, these authors conclude that managers or executives commit 46% of fraud cases.

2.2.4. M.I.C.E. Model

In 2011, Kranacher, Riley & Wells argue that situational pressure could be explained by four factors: money, ideology, coercion, and entitlement (MICE) as follows:

- The money factor refers to financial pressure caused by debt, family needs, and others.
- The ideology factor believes that the act of committing fraud is for the greater good.

- The coercion factor refers to a third party forcing the act of fraud through intimidation and threats.
- The entitlement factor indicates the ego of the person committing the fraud to believe that they will never be caught, in addition to the desire to reinforce or obtain a certain status in their environment.

2.2.5. The New Fraud Triangle Theory

Some theories and models try to explain the fraud that occurs inside organizations. A new model was proposed to combine all the major existing theories to explain why people commit fraud (Kassem & Higson, 2012). Figure 2.5 summarizes this model:

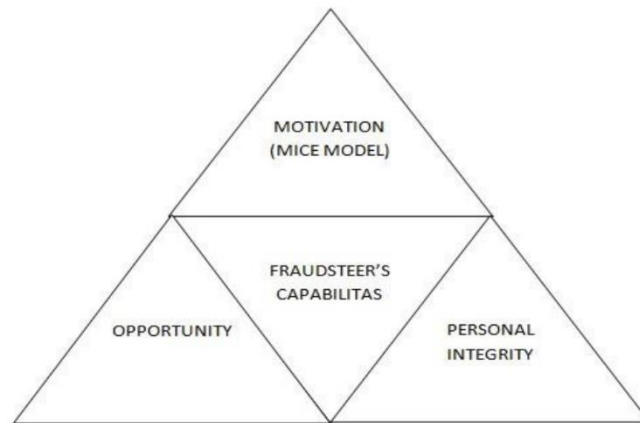


Figure 2.5 - The New Fraud Triangle Model (Kassem & Higson, 2012)

This new model consists of:

- Motivation, based on the MICE model, suggesting that motivation is determined by money, ideology, coercion, and ego (Kranacher, Riley, & Wells, 2011).
- Opportunity is similar to that of the Fraud Triangle Theory (Cressey, 1953).
- Integrity, based on the Fraud Scale personal integrity, is most applied in financial reporting fraud situations where the pressure is most visible (Albrecht, Howe, & Romney, 1984).
- Capability is similar to that in the Fraud Diamond Theory (Wolfe & Hermanson, 2004).

2.3. Frauds and Businesses Groups

Many authors state that there is an inverse relationship between Corporate Governance and the rate of fraud committed in companies. That is, a weak CG structure

is one of the leading causes of financial fraud (Yang, Jiao, & Buckland, 2017; García Lara, Osma, & Neophytou, 2009). Nevertheless, many reasons and variants make fraud possible. For example, since managers have access to different information, they can manipulate the board of directors, ignoring the interests of stockholders (Williamson, 1984). According to the fraud theories explained above, when a company presents duality in the positions of chairman and Chief Executive Officer (CEO), it jeopardizes the quality of the firms' financial report (Nasir & Hashim, 2021). In fact, under this scenario, a single person has enormous control over the company, which furthers his/hers capabilities and opportunities to commit fraud. This is especially true in conglomerates that are family-owned and run, since most family members hold senior positions in the company (Minor, Patrick, & Wu, 1995).

2.4. Chapter summary

Hence, this dissertation aims to identify and analyze the relevant literature on conglomerate fraud in Japan and South Korea, intending to identify the existing gaps for further development.

The conglomerates were selected based on the study of Minor, Patrick & Wu (1995), mainly due to management peculiarities of the *Keiretsu* and *Chaebol* as these entities are based on the banking system and family-owned, which may directly influence the occurrence of frauds. To understand how those frauds occur, two main complementary theories were presented (FTT and FDT), in which the respective authors defend that frauds only happen when a series of variables are fulfilled. In that sense, it is essential to understand each one of those variables since their relationship is of great importance to accountants, who are responsible for identifying situations where financial fraud may occur (Beasley, 1996) and preventing it. This highlights the importance of a comprehensive investigation of this theme, especially when three other presented models are grounded on those theories.

3. Methodology

This paper employs a systematic literature review (SLR) to achieve its primary goal. This methodology allows the selection and evaluation of previous research, minimizing the researcher's biases (Higgins, et al., 2021), and can be a valid mechanism to identify gaps in the current knowledge (Evans & Benefield, 2001). To be done appropriately, an SLR must be clear so that other can reproduce it and find the same results (Higgins, et al., 2021; Gough, 2007).

3.1. Systematic Literature Review

This methodology was developed in the medical field based on evidence-based policy and practice. Later, it was designed for other research areas (Denyer & Tranfield, 2009), and adapted to the needs of each one of them. This methodology is not merely a literature review since, through the analysis of relevant published studies, it can explore a specific objective, evaluate existing problems, and help to find alternatives to circumvent them and gaps in the literature for future research. Furthermore, it differs from other methods as it requires inclusion and exclusion criteria, which must be well specified in advance. One of the main characteristics of this methodology is its ability to be replicated by any researcher who reads the study. The explicit use of the SLR aims to raise more reliable results that will help construct conclusions (Antman, Lau, Kupelnick, Mosteller, & Chalmers, 1992).

The systematic literature review is naturally employed in the management area. Yet, one may face great difficulties in implementing it due to this area's high interdisciplinarity (Tranfield, Denyer, & Smart, 2003) and subdivisions (Whitley, 1984) that generate many hypotheses and conclusions (Baligh, Burton, & Obel, 1996). For this reason, it has been determined that this study will follow the protocol defined by (Denyer & Tranfield, 2009), illustrated below:

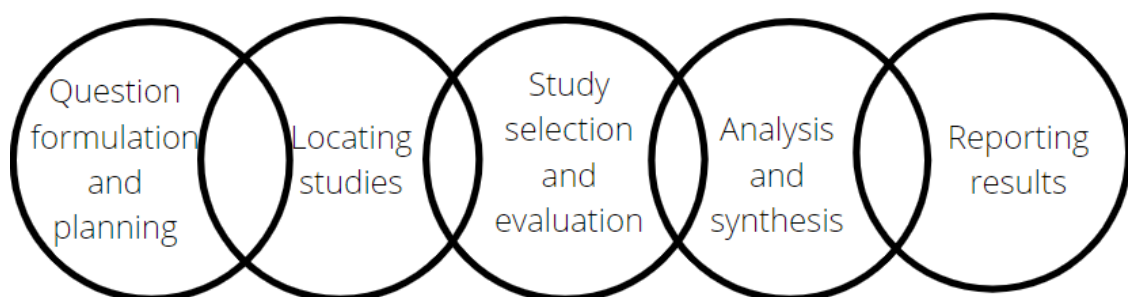


Figure 3.1 - SLR protocol

As we can see, the SLR has five main steps: planning the work, selecting, and evaluating studies, and analyzing and synthesizing them to report the results. All these steps will be further detailed in the following topics of this chapter.

3.2. SLR Steps

Due to the protocol selected for this literature review, specific steps must be followed. In this section, each of them will be explained in detail.

3.2.1. Revision Planning

The first step is determining the review's focus by formulating a question to be answered (Counsell, 1997). In this case, the theme was defined according to the author's interests. The initial idea was to study conglomerates worldwide but, as this is a very vague and extensive subject, a scoping study was conducted to refine a possible theoretical background to explore this issue. This initial step led to the conclusion that frauds were more likely to occur in Asian companies, especially in those where a certain type of family structure prevails. Thus, it was decided that the focus of this study would be to conduct an SLR to analyze the different conglomerates in Japan and South Korea and how these structures link with problems of financial fraud. At this point, an advisory group must be selected to assist at critical points throughout the systematic review process (Denyer & Tranfield, 2009), which is as follow:

- Luís Miguel Serra Coelho, Assistant Professor at the Faculty of Economics, University of Algarve.
- Rúben Miguel Torcato Peixinho, Assistant Professor at the Faculty of Economics, University of Algarve.

3.2.2. Delimitation of studies

The systematic literature review aims to cover as many relevant publications as possible, and the process of searching for these studies should be detailed. This entail defining a search strategy based on keywords and search string and identifying suitable databases to search for the relevant papers.

3.2.2.1. Definition of the databases

Since we must identify all relevant studies on the topic of interest, we should select an extensive database encompassing studies from several journals. Hence, for this SLR, the databases considered are the following: ScienceDirect, which is a comprehensive

scientific bibliography database containing numerous academic journals belonging to the Elsevier publisher; Online Knowledge Library (B-ON), which is a platform that holds a variety of article sources; and Scopus, which links scholarly literature across a wide variety of disciplines by abstract and citation database.

3.2.2.2. Definition of keywords

The search for relevant studies requires identifying relevant keywords, which must be combined into meaningful strings. The keywords selected for this review were based on the literature found during the framework development and are as follows:

Regarding the conglomerates	Regarding frauds
1. Keiretsu	1. Corporate Fraud
2. Japanese Conglomerate	2. Financial Statement Fraud
3. Chaebol	3. Financial Fraud
4. Korean Conglomerate	4. Financial Crimes
	5. Financial Scandal

Table 3.1 - Definition of keywords

Each of the keywords in Table 3.1 was chosen for a reason. In practice, the subset of keywords related to conglomerates were highlighted during the scoping study. Those for fraud were selected as follows. "Corporate Fraud" covers all studies related to any category of illegal activity within a company, whether committed individually or by the conglomerate itself. "Financial Statement Fraud" is a less recurrent fraud but is the costliest. Hence, this keyword was included to cover studies on fraud related to the financial reporting. "Financial Fraud" is a more generic keyword than the previous one but aims at identifying studies about frauds in the financial area. "Financial Crime" intends to identify articles about fraudulent behaviors in conglomerates. Finally, "Financial Scandal" was selected to identify studies involving manipulation in the accounting of conglomerates and the financial market.

3.2.2.3. The research strings

Selected keywords are combined to identify the relevant studies to this research published between 2010 – 2022, based on the Boolean research method as follows:

Keywords	Objective
("Keiretsu" OR "Japanese Conglomerate") AND ("Financial Statement Fraud" OR "Financial Fraud" OR "Corporate Fraud")	Relevant studies about Financial Frauds in Japanese Conglomerates
("Keiretsu" OR "Japanese Conglomerate") AND ("Financial Crime" OR "Financial Scandal")	Relevant studies about Financial Crimes and Scandals in Japanese Conglomerates
("Chaebol" OR "Korean Conglomerate") AND ("Financial Statement Fraud" OR "Financial Fraud" OR "Corporate Fraud")	Relevant studies about Financial Frauds in Korean Conglomerates
("Chaebol" OR "Korean Conglomerate") AND ("Financial Crime" OR "Financial Scandal")	Relevant studies about Financial Crimes and Scandals in Korean Conglomerates

Table 3.2 - Research chain

I looked for studies published from 2010 onwards since companies changed dramatically with the beginning of the IV Industrial Revolution (Philbeck & Davis, 2018). Such change helped merging physical and virtual businesses, forever altering firms' modus operandi and, also because I looked for a time period that would not be too small or too large. Based on this rationale, papers published before 2010 were excluded from this systematic literature review.

3.2.3. Selection and evaluation of scientific studies

Selection starts by applying the research strings to the identified databases, which helps to create an initial list of literature related to the subject of interest. Next, inclusion and exclusion criteria are used, which are defined in the following points.

3.2.3.1. Exclusion criteria

All papers identified with the help of the search strings are assessed using exclusion criteria. This entails reading their title and abstract to exclude:

- Studies without any relation to financial fraud or Japanese or Korean conglomerates.
- Duplicate studies.
- Studies that have not been published in scientific journals.

3.2.3.2. Inclusion criteria

In the next step, the studies that meet the exclusion criteria are assessed using inclusion criteria. In particular, these papers are read in full, and the following criteria are applied:

- The study has an explicit relationship with previous work and existing theory.
- The study makes a relevant contribution to existing knowledge.

In addition, the following criteria are also applied to all empirical studies:

- The paper explicitly defines the methodology and presents a clear interpretation of the results based on the existing literature.
- The paper clearly presents the hypotheses, variables, and parameters of the models applied.

For the more theoretical studies, the following criteria are also applied:

- The objectives and assumptions of eventual models are clear.
- The model under study and the theory and previous works are explicit.

4. Results

This Chapter presents the results of applying the methodology described previously, from extracting of the articles to applying the exclusion and inclusion criteria.

4.1. Article extraction

The articles were extracted on April 19th, 2022, prioritizing papers in business and management, economics, and finance published between 2010 and 2022. Table 4.1 summarizes the results per search string and database:

Research Chain	Article extraction		
	B-ON	ScienceDirect	Scopus
("Keiretsu" OR "Japanese Conglomerate") AND ("Financial Statement Fraud" OR "Financial Fraud" OR "Corporate Fraud")	36	8	5
("Keiretsu" OR "Japanese Conglomerate") AND ("Financial Crime" OR "Financial Scandal")	20	4	5
("Chaebol" OR "Korean Conglomerate") AND ("Financial Statement Fraud" OR "Financial Fraud" OR "Corporate Fraud")	37	18	0
("Chaebol" OR "Korean Conglomerate") AND ("Financial Crime" OR "Financial Scandal")	7	5	1
TOTAL	100	35	11

Table 4.1 - Article extraction

4.1.2. Article selection

After applying the exclusion criteria detailed above, 125 articles were eliminated from the list of articles extracted, as specified in the table below:

Exclusion Criteria	N
Duplicate articles	24
Articles not related to the topic of the SRL	88
Article not published in a scientific journal	13
Total	125

Table 4.2 - Exclusion criteria

More details about the articles not related to the topic of interest in Appendix 1.

4.1.3. Application of the inclusion criteria

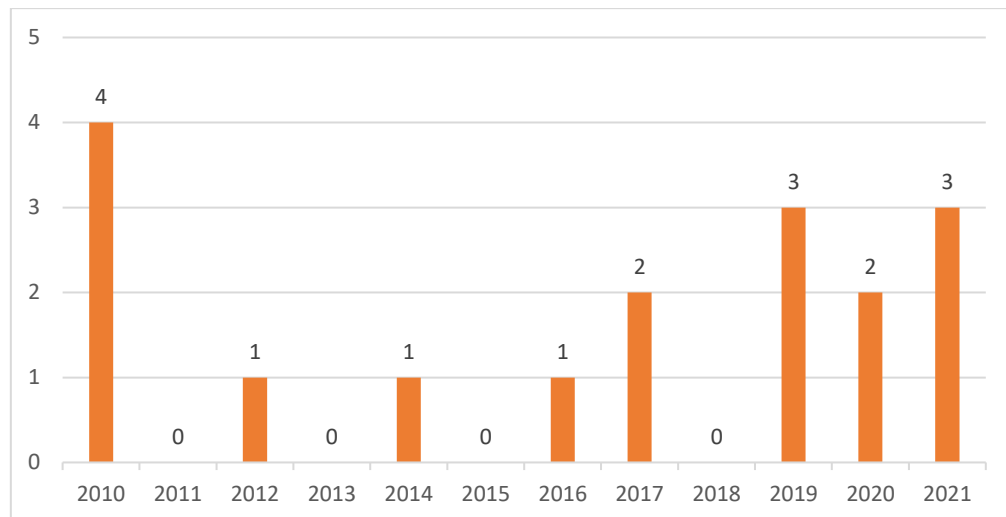
The twenty-one studies that passed the exclusion criteria were submitted to the inclusion criteria explained in the previous chapter. In this step, 12 studies were included for presented relevant contribution, explicit relationship with previous work, models, and theories. More details about the articles excluded during this step in Appendix 2.

4.1.4. Unidentified literature included in the review

The final sample consists of 12 articles identified above and another three located in the scoping study. These articles met all the inclusion and exclusion criteria of this SLR and are specified on Appendix 4. Thus, the final sample consist in a total of 15 articles.

4.2. Descriptive statistics of the articles

According to graph 4.1, the publication of studies related to fraud in Japanese and Korean conglomerates is not stable over the last 12 years. In fact, that are no publications matching the criteria in the year 2011, 2013, 2015 and 2018. In addition, the topic seems to have generated some interest in the last three years covered by this SRL, since it has a higher and consistent number of publications per year comparing to previous years, apart from 2010 having the highest number of publications registered in the selected time period.



Graph 4.1 - Number of articles per year

4.3. Publication of results

This chapter presents the results of the systematic literature review, based on the 15 papers identified as relevant for the understanding of this theme. The results show that corporate fraud can be classified in countless ways. Additionally, academic studies addressing this issue are widely different depending on the author's objective, which leads to many controversial conclusions. Interestingly, given that fraud is clearly an empirical topic, it has been studied by using event studies that explore market behavior (Choi, Lim, & Mali, 2017; Song & Han, 2017), or via case studies that have a solid theoretical emphasis (Konishi, 2010; Albrecht, Turnbull, Zhang, & Skousen, 2010; Rahman & Bremer, 2016; Lee, Wan, Lee, & Park, 2019). Other methodologies, grounded in solid theory, are also used in the literature to explore particular issues relating to market behavior in the face of fraud (Numata & Takeda, 2010; Skinner & Srinivasan, 2012; Frendy, 2014; Demetriades & Owusu-Agyei, 2021).

4.3.1. Types of Fraud

Fraud is an extensive term that means, according to the Cambridge dictionary, a crime of getting money or personal gain by tricking or deceiving people. Yet, the academic literature does not present a unanimous definition of fraud as the sample papers tend to adjust its definition based on their research objectives. For instance, Lee, Eun, Lee & Park (2019) defines it as an opportunistic management behavior to receive the associated bonus of production targets whereas Song & Han (2017) refers to white-collar crime in this context, which cause not only reputation damage, but it also generates direct costs and losses to the company and mainly involve financial and accounting

manipulation of information provided to stakeholders. Konishi (2010) identifies “professional occupational crimes” when individual practitioners take advantage of their unique professional opportunities, in line with the fraud theories analyzed in Chapter 2, whilst, in a parallel contribution, Rahman & Bremer (2016) argues that financial reporting fraud occurs when sales or expenses for the period are misreported.

The regular practice called window-dressing, although not considered fraudulent (Albrecht, Turnbull, Zhang, & Skousen, 2010), is a way to manipulate and make the company's performance look better than it is (Kawasaki, 2010). This practice has allowed most of the financial scandals associated with accounting fraud to occur in Japan. In addition, studies have also demonstrated that the penalties for misstatements are less severe in Japan compared to the USA (Skinner & Srinivasan, 2012; Frendy, 2014; Rahman & Bremer, 2016), even though the penalties can reach up to two years of inability to practice auditing or the dissolution of the auditing company.

4.3.1.1. Frauds committed by CPAs

Frauds committed by Certified Public Accountants (CPAs) are usually related to the approval of financial reports that contain errors or manipulation of the results. There are several cases that exemplify this kind of fraud, with Konishi (2010) investigating the characteristics of three of these cases. The first one is the Eron case, in which the company started to cook its books on a massive scale. It took advantage of SPEs (special-purpose entities) by fraudulently using accounting methods to make the firm look healthier than it was. The same happen with two Japanese cases, Kanebo and Livedoor, where the audited firms conferred a stamp of approval on the books cooked by the management. The accounting fraud of Livedoor was remarkably like the Enron scandal because the management of *Livedoor* engineered a plan for the company's rapid growth and corresponding wealth, which drove them to fraud. However, it differed from the *Kanebo* case because, in this last one, the motivation for using fraudulent accounting was to cover up losses and keep the company afloat.

Konishi (2010) concluded that the way people form and maintain their relationships in each society is significantly related to fraud. Japanese people of all generations are socially controlled rather than by legal and ethical norms of the country. This evidence suggests that researchers need to consider these cultural backgrounds while investigating criminal phenomena, including fraud perpetrated by CPAs, as reinforced by

Frendy (2014) that studied the Olympus case. In a contribution to avoid such negative events, Konishi (2010) suggest that the CPAs' independent status should be guaranteed by obtaining auditing contracts and compensation from an independent organization funded for public companies rather than clients. The rotation of the audit system was also suggested by Rahman & Bremer (2016) and Choi, Lim & Mali (2017) as an attempt to decrease the incidence of corporate fraud.

4.3.1.2. Accounting Fraud

Accounting fraud is a common type of corporate fraud with several cases reported in Japan and South Korean. One of the biggest accounting fraud scandals in South Korea was thoroughly studied by Lee, Eun, Lee & Park (2019). The case of Daewoo Shipbuilding & Marine Engineering (DSME) chocked the market as the management took advantage of the weakness of the process to recognize revenues and expenses based on the percentage of completion method according to the International Financial Reporting Standards (IFRS). This is particularly evident for long-term projects, where it is more likely to have over or underestimated values. Even though the external auditors recognized the flaws associated to the estimated value of the projects, they helped DSME to falsify the company's credit rating to avoid revealing its potential risk.

Similarly, Demetriades and Owusu-Agyei (2021) identified that, due to the pressure that Toshiba's executives were under to achieve almost impossible results, they also employed the estimated completion percentage method on the projects they were involved. This paper also noticed that, when the accounting errors started, Toshiba played a negative return on assets (ROA), which is in line with Sakawa & Watanabel (2021) conclusion that unprofitability increases the likelihood of corporate fraud.

Frendy (2014) reported a similar situation in the Olympus case. During the 1980s, or Bubble Years, as the economy grew and investors were excited to invest in the stock market (Kawasaki, 2010), Olympus started a scheme to hide their losses from previous investments. Even with the attempts to recover those losses, this was not possible, and the company continue to use the improper loss transfers method, until everything came to light.

4.3.2. Motivation

Based on the fraud theories previously studied, it is possible to identify some fraud determinants. In some cases, the preeminent motive is to fulfill the objectives of the company (Lee, Wan, Lee, & Park, 2019), to avoid bankruptcy (Numata & Takeda, 2010), or even to hide losses (Frendy, 2014).

Relying on FTT, Albrecht, Turnbull, Zhang & Skousen (2010) analyzed four cases that happen in Korea to point out their main reasons for fraud:

- *Daewoo*: sold their assets above their book value to its affiliates and used that profit to achieve a rapid growth.
- *SK Global*: was involved in a stock manipulation scandal, ensuing the chairman at the time, to control the group's principal subsidiaries. This case stands out because it is one of the cases in which, after a few months in jail, the CEO returned to his position in the company.
- *Samsung*: an investigation found that the Chairman, together with some executives, facilitated the illegal purchase of 64% shares of a holding company for well below market value by his son. This investigation also found illegal sponsors in some election campaigns of politicians who would facilitate its business in the USA.
- *Hyundai*: the logistics executives were arrested for embezzling over \$6 million. Moreover, to add to the scandal, the Chairman was arrested for making deals that benefited his family.

Albrecht, Turnbull, Zhang & Skousen (2010) thus identify the main reasons for frauds in conglomerates based on the Triangle Fraud Theory as can be seen in Figure 4.1. The pressures presented are self-explanatory. Of the opportunities that conglomerate present, the authors concluded that the main must be the lack of independence among the companies. Finally, rationalization is always considered one of the limitations of all studies on the subject because the accused always plead innocent and never present the real motivation that led them to commit the frauds.

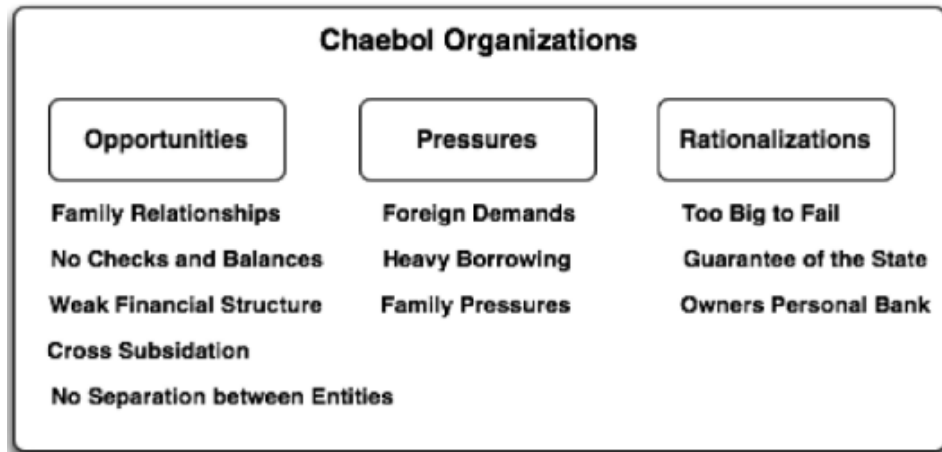


Figure 4.1 - Weakness according to FTT (Albrecht, Turnbull, Zhang, & Skousen, 2010)

In the same way, Demetriades & Owusu-Agyei (2021) analyzed the motivation behind the Toshiba case through two different theories, the Fraud Diamond Theory, and the Beneish M-Score model. This paper reinforces Sakawa & Watanabel (2021) and Lee, Eun, Lee & Park (2019) conclusions, by suggesting that fraud is more likely when companies have low ROA or fail to have a monitoring system and a good internal control.

FTT offers an important contribution to understand corporate fraud as it describes the forces that make people ignore risks and whether they use the opportunities to benefit from fraudulent acts (Karpoff, 2021). This model can be used to understand how reputation and the incidence of fraud are affected by the competitive and demanding market environment, allowing the incidence of fraud to increase in situations such as (Karpoff, 2021):

- Lower transaction costs attract new consumers and investors into the market, making fraudulent activities last longer, and perpetrators find new partners to transact with;
- With lower transactions, companies easily increase their profitability when offering low-quality products, consequently lowering the quality of financial reporting and expanding the opportunity to commit fraud;
- Increased anonymity, by technologies such as blockchain that facilitates transactions without the need to identify oneself, allows the gain for fraud to increase and perpetrators to return with their activities in the market even after having committed fraud previously.

4.3.3. Market Reaction

Some articles included in this systematic review evaluate the market reaction when the fraud is announced and conclude that culture is crucial to understand whether the market deals with fraud. For instance, during the Olympus case, Frendy (2014) concluded that Japanese investors' lack of response to fraud news is due to the existing expectation that audit failures are likely to happen. Similarly, Albrecht, Turnbull, Zhang & Skousen (2010) concluded that most financial frauds are seen by the Korean society as clever financial maneuvers and not as unethical acts.

There is also evidence of unusual market reaction in Japan to fraud. For instance, during the news that *ChuoAoyama* was directly involved in the Kanebo case, Numata & Takeda (2010) noticed that the entire market lost value due to investors' mistrust that the same thing could happen to other companies. To overcome this situation, PricewaterhouseCoopers (PwC) came up with the solution of creating two different companies: *Aarata*, considered a high-quality firm, which would be responsible for clients with international business; and *Misuzu*, which was nothing more than a reformulation of *ChuoAoyama*. which worked until the close of *Misuzu*. According to Skinner & Srinivasan (2012), this only happened because the audit quality of Japanese companies is not as important as for their Western counterparts. However, this seems to be specific to Japanese firms as Song & Han (2017) suggests that the market reaction for Korean firms is similar to the US stock market. As the Japanese market is the most differentiated from the rest, these characteristics were evidenced once again during the Toshiba case that made the whole Japanese control system be questioned, affecting all companies present in the market (Demetriades & Owusu-Agyei, 2021).

4.3.3.1. Street Crime

Although the street crimes are not directly related to companies, it can influence the way the stock market reacts due to the position that these people have in the company, and includes tax fraud, violation of labor and environmental rights, bribes to get contracts.

Song & Han (2017) show no statistical difference in the negative market reaction around corporate crimes events between announcements of individuals and organizational crimes. However, the market may not react as seriously to an individual executive's street crimes as it does to white-collar crimes. According to their data, the market may not take the indirect reputational loss as seriously as it takes the direct

financial loss from white-collar crime and may consider street crimes as personal matters. It may also indicate that the market believes South Korean corporations may be free to dismiss problematic executives with relatively little loss.

4.3.3.2. Reputation Loss

Frendy (2014) explored whether the news published in the Olympus case influenced the reputation of auditors. Similarly to Skinner & Srinivasan (2012), Frendy (2014) suggests that the Japanese stock market assumes fewer conservative reactions to news of accounting misconduct.

Numata & Takeda (2010) also investigates the impact of fraud announcements on the auditors' reputation through the *Kanebo* and *ChuoAoyama* case. This paper relies on the assumptions of safety and reputation, which refer to the auditors' guarantee that there will be no loss if there is an "error" in the financial statement. The latter assumption concerns the audit quality associated with the certified services provided in case of agency problems. Skinner & Srinivasan (2012) also tried to understand the importance of auditor's reputation, through the same case, because companies, for the most part, tend to switch auditors when quality is questioned, so they avoid any consequences that the market may present, such as a drop in their market value. As consequence, the auditors lost their reputation and the investors lost their trust, affecting the entire market.

4.3.4. Company Structure

The company's fragility and the propensity to fraud verified in the Toshiba case, raised serious doubts about whether the control systems of Japanese firms were effective (Demetriades & Owusu-Agyei, 2021). Therefore, it is important to fully understand the relationship between companies' structures and the propensity to commit corporate fraud.

4.3.4.1. Centralized Firms

The Korean chaebol have a peculiar structure where the affiliated firms have their businesses centralized in the main firm. Choi, Gam & Shin (2017) analyzes the differences in corporate fraud by comparing the frequency of fraud in intra-group transactions committed before and after the 2001 regulatory reform by centralized and non-centralized firms. The results indicate that corporate fraud investigations increased in centralized firms, possibly due to the owners' desire to maximize the profitability of the central firms while sacrificing the subsidiaries' performance through unfair transactions at reduced prices. In sum, the authors concluded that, during the post-

regulatory reform period, the central firms of pyramidal groups showed a decrease in corporate fraud with the limitation of their influence on the subsidiaries that somehow managed to prevent the frequency of unfair insider transactions intended to favor the central firm. In other words, at the performance level, the subsidiary firms grew. In contrast, the central firms deteriorated in this period (after 2001), which further evidences the controlling owners' intention to benefit from insider transactions.

4.3.4.2. Corporate Governance

Some of the reported cases indicate that there is a tendency for fraud when companies present a weak internal control system and Corporate Governance structure (Sakawa & Watanabel, 2021; Lee, Wan, Lee, & Park, 2019).

Rahman & Bremer (2016) assumes, in their Japanese based study, that quality financial reporting has good corporate governance as a prerequisite. Even though this debate is relatively new to *keiretsu*, Rahman & Bremer (2016) suggests that, although the main bank system and stakeholder governance indicate that the traditional focus on shareholders' rights and values are almost nil, the new CG code changes companies' behavior in this domain. The appointment of outside directors to different boards and other initiatives aiming at separate ownership and management constitute examples of these changes. However, this new code does not imply sanctions and it is not equivalent to a law. The authors concluded that the reduction of fraudulent financial reporting is a prerequisite for effective corporate governance. Thus, they suggested some changes in the way Japanese companies operate, such as:

- A specific board should be created to report shareholders' concerns and interests;
- The size of the boards should be reduced, and at the same time, half of the members should be outsiders;
- Companies should simplify the voting process and encourage the presence of shareholders at annual meetings;
- Companies should improve communication with foreign shareholders;
- CPAs should be changed every 3 years;
- All reporting and GC measures should focus on fraud prevention rather than just following regulations;
- All transactions and deals related to directors and major shareholders should be terminated immediately;

- It should be mandatory for all listed companies to adopt IFRS;
- Companies should create a system for reporting fraudulent acts.

4.3.4.2. Main-bank

Japanese companies also have distinct characteristics. For instance, the relationship between bank and company stands out due to the dominance that the bank has over its client. Besides having access to all the company's information, they still choose a director or external auditor to control and make sure that their creditor will not get into financial difficulties. This peculiarity fueled Sakawa & Watanabel (2021) to focus on the relationship between bank monitoring, accounting fraud and its consequences.

Based on the FTT, it can be stated that the bank's control over its creditors reduces the opportunities for fraud since monitoring aims to minimize agency problems at the management level. However, the incentives to fraud may increase with the bank's presence, especially when the firm is not doing well financially, and executives have reason to manipulate financial reports. Finally, rationalization can also be influenced by the presence of banks, as firms become more sensitive to the pressure to earn higher profits so that management does not lose their benefits. In contrast, banks require the firm to be opposed to risky activities. Interestingly, Sakawa & Watanabel (2021) concludes that:

- Accounting fraud is significantly lower in firms with bank relationships;
- Banks can replace the audit firms control once they appoint an external auditor or director;
- There is evidence that firms with lower profitability and higher financial leverage are more likely to commit corporate fraud.

Japanese companies operate in a unique environment where CG is dominated by banks. However, the effectiveness of the Japanese is doubtful as the cases of fraud (*e.g.*, Toshiba and Olympus) are associated to weak CG mechanisms (Demetriades & Owusu-Agyei, 2021). However, Sakawa & Watanabel (2021) show that the frequent review of control activities can benefit stakeholders by strengthening business ethics and prevent corporate fraud.

4.3.4.3. Annual meeting

Gam, Gupta, Im, & Shin (2020) proposed that annual shareholder meetings can be linked to corporate fraud when it is evasively scheduled. Frequently, annual general meetings (AGMs) take place on dates considered popular as companies have a propensity to schedule them at the same time of the year. This clustering complicates the attendance of many shareholders at the meetings. Gam, Gupta, Im, & Shin (2020) results may be summarized as follows:

- Companies involved in fraud are more likely to schedule their AGM on clustering dates;
- Abrupt changes in the clustering or non-clustering meeting policy may also indicate a relationship with fraud. In fact, First Cluster companies are the most likely to be investigated for fraud, and the consequences vary between correction order and imposition of fine;
- A significant correlation between AGM clustering date and fraud is found for companies that have professional (hired) CEOs, when have election or dismissal of members on the board of audit during the meeting or have weak CG. The exception is when the industry follows the clustering policy;
- Companies seeking little attendance at their AGMs select a clustering date at a remote location to host the meeting.

Beside the clustering dates to hide a possible fraud on the AGMs, a few companies use criminal organizations to achieve their goals in many countries. However, these practices in Japan are more complex and highly regulated. This is because, after the 1960s, the laws against street crimes were reinforced, and so these criminal organizations, called *Yakuza*, migrated their business to other areas. Kawasaki (2010) analyzed the way those organizations work within the conglomerates and concluded that the branch called *Sokaiya* is used as professional shareholders. *i.e.*, the fraudulent company hire them to have more support on the shareholder meetings.

4.3.5. Initiatives to avoid fraud

The sample papers allow the identification of some mechanisms aiming to decrease the incidence of corporate fraud in the markets. The implementation of such mechanisms allows future investigation to address their outcomes. For instance, Karpoff (2021) proposed some mechanisms that companies could promote to avoid fraud:

- Lowering the cost of information helps to bring fraud-related behaviors into focus;
- Know and investigate other companies before entering partnerships and business deals;
- Increase earnings for behaviors consistent with company values and decrease incentives for fraud;
- Decrease transaction tracking creates great dependence on honesty of reporting but can be effective if the company can detect fraud.

4.3.5.1. Legislations

Through the history of the Japanese economy, Kawaski (2010) identifies the establishment of several government acts every time a new major fraud scandal was revealed. Since the 1980s, the Korea Fair Trade Commission has tried to regulate and create policies to decrease the rate of corporate fraud in Korean companies (Choi, Gam, & Shin, 2020) as investors were excited to invest in the stock market and became easy targets for frauds. The Investment Advisors Law was created in response to such risky environment. However, the following decade, the 1990s, were marked by scandals related to investment frauds, although the improved legal environment. In the 2000s, the practice of "window-dressing" to camouflage the company's accounting losses and promote cooked profits was observed by listed companies. As a result, many investors lost their money, with no chance of recovering it. Kawaski (2010) suggests that a single law should be created to regulate fraud-related crimes, rather than specific decrees that leave room for new forms of fraud.

Choi, Gam & Shin (2020) emphasizes that the Monopoly Regulation and Fair Trade Act was established in 1987 to promote corporate transparency and a fair competitive environment. This led to the regulatory reform of 2001, aiming to reduce inequality between business groups and unaffiliated companies. However, the Japanese government only in 2006 introduced new corporate accounting and auditing regulations, called Japanese Sarbanes-Oxley Act (J-SOX), and promote the auditing system reinforcement and enhancement of corporate internal controls. The new J-SOX had a significant impact on corporate accounting and the auditing system in Japan and can potentially be critical to the future prevention of accounting frauds. However, even with a restructuring of the legal system, smooth functioning is not guaranteed if people do not use it effectively.

4.3.5.2. Rotating Audit System

Konish (2010) explores three case studies related to frauds committed by CPAs (Eron, *Kanebo* and Livedoor) to understand the differences and similarities when a fraud occurs in a western country and when it occurs in an eastern country. The author suggests that the implementation of a rotating audit system may decrease the incidence of corporate fraud. This system is also suggested by Rahman & Bremer (2016) and become mandatory in South Korea. In 2001, the Financial Supervisory Commission proposed a policy of rotation of audit firms and, later on 2003, the Financial Supervisory Services, Korea's regulatory body, instituted the mandatory rotation every six years for firms with firm-by-firm basis following the SK Global and *Daewoo* cases. Still, it was not adopted until 2006 and lasted for ten years as IFRS was soon adopted. When audit rotation became mandatory, it had many negative comments. It is believed that most errors occur in the first few years until the auditor builds up knowledge about their client.

Choi, Lim & Mali (2017) empirically tested the efficiency of this rotating system. The univariate and multivariate analysis shows that the sample firms required to adopt rotation have lower audit quality than firms that adopted rotation voluntarily. This is consistent with the previous studies suggesting that accounting errors and failures usually occur in the first few years after switching audit firms. In short, Choi, Lim & Mali (2017) conclude that mandatory audit rotation did not improve the quality of financial reporting. Thus, the mandatory rotation policy of audit firms was ineffective, increased the abnormal accruals of clients and showed no influence on real earnings management.

4.3.6. Fraud prospects

Karpoff (2021) investigates the evolution of fraud across the last years and finds some conflicting results. On the one hand, new Security Exchange Committee (SEC) actions against public companies have decreased since 2003. On the other hand, the number of lawsuits alleging accounting and financial errors increased over the same period. The author speculates an increase in fraud practices over the COVID-19 pandemic period as many companies face acute financial problems, have to downsize their workforce and are closer to bankruptcy. Karpoff (2021) presents a more optimistic perspective following the pandemic period but emphasizes that this view depends on the elasticity of the FTT variables. Importantly, many authors disagree with this optimistic view as Karpoff (2021) does not account for the culture. In fact, previous studies suggest

that culture is crucial to the understanding of corporate fraud (Konishi, 2010; Albrecht, Turnbull, Zhang, & Skousen, 2010; Frendy, 2014).

5. Conclusion

This Chapter presents the conclusions of the study and exposes my reflections about the theme and the whole development of the work. It also summarizes possible future lines of research that are inspired in the sample papers and points out the limitations of this study.

5.1. Personal reflections

After all the process of searching for studies and reading about fraud in the Japanese and Korean context, it was possible to conclude that this is a vast field, just by looking at the discussion about the definition of fraud.

In my opinion, this is an interesting topic since it is possible to approach it from a business, financial, accounting, and sociological point of view. In fact, fraud is clearly a finance and accounting subject, but also involves companies and the entire (local and international) financial market. Furthermore, one can use different theories to examine this topic. Theories that consider basic human behavior are particularly important to understand this topic as many studies conclude that fraud will only have a significant impact in certain cultures (for instance, accounting practices of window-dressing are not considered fraudulent in Japan while the Korean society seems to look at this problem as clever financial maneuvering and not as an ethical issue).

In my opinion, governments do not put enough effort to create laws and regulations or mandating the implementation of IFRS, all of which could help minimize fraud cases. This is not because it is difficult to predict how and when fraud will happen; in fact, this seems to be a deliberate choice that helps increase market dynamics, which furthers the competitiveness of the national companies, making the country's economy stronger.

Finally, I believe that this topic has academic relevance and very practical applications. This is not only the conglomerates studied in this review, but for the entire world. In fact, according to the PwC survey on economic crime and fraud in companies in 2022, 46% of companies said they had suffered from fraud in the last 24 months. Interestingly, in Asia the number of companies affected by fraud is much lower: only 29%. However, asset misappropriation stands out in Asia, while cybercrime is more frequent globally. What seems to set Asia apart from the rest of the world is that two-

thirds of the fraud cases involve internal company employees, something that highlights the importance of the present study.

5.2. Future research

This systematic literature review allowed us to identify relevant studies in the field of fraud in *keiretsus* and *chaebols*. Yet, we conclude that this is a little explored field when compared to studies on fraud in China or North America and, for this reason, there are several questions to be raised. The most important ones are as follows:

- Culture is a critical variable that influences the way fraud is perceived by society (Konishi, 2010; Albrecht, Turnbull, Zhang, & Skousen, 2010; Choi, Gam, & Shin, 2020). So, it would be important to understand how culture influences the investors' perception on fraud commitment.
- Many authors point out that the Japanese expect financial and accounting failures to occur (Frendy, 2014). Furthermore, other studies (Albrecht, Turnbull, Zhang, & Skousen, 2010) suggest that the Japanese and South Korean societies share a similar view regarding corporate fraud. It would be important to revisit this conclusion using more recent data since Song & Han (2017) argues that the Korean market acts in the same way as the US market. However, this conclusion contradicts Skinner & Srinivasan (2012).
- Rahman & Bremer's (2016) emphasizes that corporate governance is a key issue to enhance the quality of financial statements. Therefore, it would be interesting to examine how the peculiar structure of each conglomerate, *i.e.*, *keiretsus* and *chaebols*, and their corporate governance structures influence the incentives of their executives to commit fraud.
- Gam, Gupta, Im & Shin's (2020) suggests that annual shareholder meetings provide important information to uncover potential corporate fraud. Considering that the mandatory electronic voting was introduced in 2014, future research may address the impact of this change in the relationship between annual shareholder meetings and corporate fraud.
- Choi, Gam & Shin (2020) investigates the relationship between the centrality of companies and the probability of the existence of fraud in conglomerate internal transactions in a conglomerate. This research can be complemented by introducing factual information about the real viability of conglomerates with high

centrality and verifying if there is an optimal level of centrality for the main company.

- Some authors (Albrecht, Turnbull, Zhang, & Skousen, 2010) have pointed out that some executives convicted of fraud have returned to their previous positions after serving their sentences (*e.g.*, Japanese executives). Trying to understand how and why this happens and how the market reacts to this peculiar event would be an interesting topic for future research.
- Finally, the existing literature is somewhat concentrated in the pre-2010 era and, as such, does not consider the impact of the changes brought by the Fourth Industrial Revolution. Hence, it would be interesting to revisit previous knowledge considering cases of corporate fraud that occurred after 2010. This seems especially promising due to the popularization of cybercrime, a theme presented in many reports released by PwC in the recent years.

5.3. Limitations

This study uses the SRL methodology to identify papers that examine the relationship between fraud and Japanese and Korean conglomerates. Although having numerous advantages over the traditional literature process, the SLR is not flawless. For instance, if the keywords and search strings of this study are not totally accurate, the process may fail to identify relevant studies in this theme. Furthermore, although the process requires using pre-defined inclusion and exclusion criteria to assess the quality and relevance of the studies included in the final review, it is still hard to avoid biases that naturally arise due to the preferences of the researcher.

For these reasons, many different search structures were tested over the development of this study. The final configuration was completed after a comprehensive analysis, with the objective of maximizing the number of relevant papers included in the review. However, this still does not guarantee that the final work is fully accurate.

5.4. Concluding remarks

This dissertation systematically reviews the relevant literature on conglomerate fraud in Japan and South Korea, aiming to compile the primary studies and identify existing gaps for further development. In a nutshell, this field of study is still little explored and is based on theories instituted for more than fifty years. The last decade

shows that empirical studies have gained prominence in the area and there are many research avenues to explore.

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Appendix 1 – Articles excluded that are not related to the topic

- 3 articles related to African Conglomerates
- 2 articles related to Agency Cost
- 4 articles related to Business Groups but not related to Financial Frauds
- 11 articles related to Corporate Boards unrelated to Financial Frauds
- 25 articles related to Corporate Governance unrelated to Financial Frauds
- 5 articles related to Corporate Performance unrelated to Financial Frauds
- 3 articles related to Financial Crisis unrelated to Financial Frauds
- 4 articles related to Financial Institutions unrelated to Financial Frauds
- 1 article related to Frauds but unrelated to Financial Frauds
- 2 articles related to Frauds at Chinese Conglomerates
- 2 articles related to Frauds in US Conglomerates
- 1 article related to Frauds in Malaysian Conglomerates
- 1 article related to Frauds in Italian Conglomerates
- 2 articles related to Investments unrelated to Financial Frauds
- 9 articles related to Ownership unrelated to Financial Frauds
- 1 article related to Stock Market unrelated to Financial Frauds
- 12 articles unrelated to Conglomerates or Financial Frauds, in IT, law and other areas

Appendix 2 – Articles identified in the search strings that do not meet the inclusion criteria

- 4 articles with no relevant contribution
- 2 articles with no explicit relationship with previous work and theories
- 3 articles with no explicit model and theory

Appendix 2 - Literature identified in the search strings that meets all the selection criteria

1. Albrecht, C., Turnbull, C., Zhang, Y., & Skousen, C. J. (2010). The relationship between South Korean chaebols and fraud. *Management Research Review*.
2. Choi, D., Gam, Y. K., & Shin, H. (2020). Corporate fraud under pyramidal ownership structure: Evidence from a regulatory reform. *Emerging Markets Review* 45, 100726.
3. Choi, J. S., Lim, H., & Mali, D. (2017). Mandatory Audit Firm Rotation and Big4 Effect on Audit Quality: Evidence from South Korea. *Asian Academy of Management Journal of Accounting and Finance*, 1 - 40.
4. Demetriades, P., & Owusu-Agyei, S. (2021). Fraudulent financial reporting: An application of fraud diamond to Toshiba's accounting scandal. *Journal of Financial Crime*.
5. Kawasaki, T. (2010). Big Investment Fraud and "Yakuza Money" Crime: Two Perspectives of Financial Crime in Japan. *Asian Criminology*, 89 - 98.
6. Konishi, T. (2010). Fraud by Certified Public Accountants in Japan and the United States. *Asian Journal of Criminology* 5.2, 99 - 107.
7. Lee, H., Wan, E. S., Lee, H. Y., & Park, G. (2019). Failure of control environment of Daewoo shipbuilding & marine engineering Co, Ltd. *Asian Case Research Journal* 23.02, 561 - 593.
8. Rahman, K. M., & Bremer, M. (2016). Effective Corporate Governance and Financial Reporting in Japan. *Asian Academy of Management Journal of Accounting Finance*, 93 - 122.
9. Sakawa, H., & Watanabel, N. (2021). Accounting frauds and main-bank monitoring in Japanese corporations. *Journal of Business Ethics*, 1 - 17.

10. Skinner, D. J., & Srinivasan, S. (2012). Audit quality and auditor reputation: Evidence from Japan. *The Accounting Review* 87.5, 1737 - 1765.
11. Song, C., & Han, S. H. (2017). Stock Market Reaction to Corporate Crime: Evidence from South Korea. *Journal of Business Ethics* 143.2, 323 - 351.

Appendix 3 - Literature identified outside the search strings that meets all the selection criteria

1. Frendy, D. H. (2014). Japanese stock market reaction to announcements of news affecting auditors' reputation: The case of the Olympus fraud. *Journal of Contemporary Accounting & Economics* 10, 206 - 224.
2. Karpoff, J. M. (2021). The future of financial fraud. *Journal of Corporate Finance* 66, 101694.
3. Numata, S., & Takeda, F. (2010). Stock market reactions to audit failure in Japan: The case of Kanebo and ChuoAoyama. *The International Journal of Accounting* 45, 175 - 199.

Appendix 4 - Summary of the included articles in SLR

Title	Author	Year	Journal	Objective	Conclusion
The relationship between South Korean chaebols and fraud	Albrecht, Turnbull, Zhang & Skousen	2010	Management Research Review	Understand the causes of the fraud scandals at chaebol organizations	<ul style="list-style-type: none"> • Culture influences how fraud is viewed; • Most of the cases were seen before Korean society, not as unethical acts, but as clever financial maneuvers
Big Investment Fraud and "Yakuza Money" Crime: Two perspectives of Financial Crime in Japan	Kawasaki	2010	Asian Criminology	Identify the characteristics of the frauds committed by CPAs and to study the reactions generated by these frauds by analyzing two variables of financial fraud	<ul style="list-style-type: none"> • The different authorities, such as NPA, PPO and SEC, must coordinator and cooperate in the investigation of the crimes; • The government must do campaigns to provide knowledge to make public awareness of financial crimes
Fraud by Certified Public Accountants in Japan and the United States	Konishi	2010	Asian Criminology	Analyze three big accountant fraud to clarify the characteristics of the frauds perpetrated by CPAs and the social reactions to the offenses	<ul style="list-style-type: none"> • It is need to ensure the independence of each individual auditor; • The way which CPAs and their clients form and maintain their relationship is a crucial fact in the genesis of frauds;

					<ul style="list-style-type: none"> •The new system, Sarbanes-Oxley can potentially be important to the future prevention of accounting frauds; •Is needed to consider these cultural backgrounds while researching criminal phenomena
Stock market reactions to audit failure in Japan: The case of Kanebo and ChuoAoyama	Numata & Takeda	2010	The International Journal of Accounting	Define the effects of loss of reputation by auditors through the Kanebo and ChuoAoyama case	It was possible to see that with the announcement of the accounting fraud and the penalties for those responsible, the entire market reacted and lost value. Still, mainly the other CA clients, who had nothing to do with the fraud, saw their market value fall due to investors' mistrust that the same thing could happen to these companies. The same happened to the other companies in the market that were Big4's clients, but to a lesser extent.
Audit quality and auditor reputation: Evidence from Japan	Skinner & Srinivasan	2012	The Accounting Review	Analyze the importance of auditor's reputation through ChuoAoyama and Kanebo case	Audit quality generally, compared to Western companies, is less important for Japanese companies
Japanese stock market reaction to announcements of news affecting auditors'	Frendy	2014	Journal of Contemporary Accountig & Economics	Study how the news published at the case's time influenced the reputation of auditors from the point of view of the	<ul style="list-style-type: none"> •Japanese investors' lack of response to fraud news is because they already expect that some audit failure is going to happen;

reputation: The case of the Olympus fraud				companies that they audited through the Olympus case	<ul style="list-style-type: none"> • Companies listed on the Japanese market have been equally negatively affected
Effective Corporate Governance and Financial Reporting in Japan	Rahman & Bremer	2016	Asian Academy of Management Journal of Accounting and Finance	Explore financial reporting in Japan under the presumption that accurate financial reporting is a prerequisite for effective Corporate Governance	<ul style="list-style-type: none"> • Boards should create a new committee alongside the existing committees to address outside shareholder queries, concerns and suggestions; • Companies should change their certified public accountants every three years; • All reporting and CG measures should focus on prevention of malpractice rather than simple compliance with regulations.
Mandatory audit firm rotation and Big4 effect on audit quality: Evidence from South Korea	Choi, Lim & Mali	2017	Asian Academy of Management Journal of Accounting and Finance	Provide evidence on the importance of an auditor's reputation for quality	<ul style="list-style-type: none"> • Mandatory audit firm rotation does not perform its intended purpose to enhance audit quality; • In some instances, audit quality decreases compared to periods of mandatory audit partner rotation; • The mandatory audit rotation policy did not improve audit quality in a Korean context
Stock Market Reaction to Corporate Crime: Evidence from South Korea	Song & Han	2017	Journal of Business Ethics	Analyze the public perception of news of white-collar and street crimes, committed by the corporation or a company	They believe that how the Korean stock market reacts is like the American stock market, contradicting most researchers who

				executive, and the consequences for companies	claim differentiated stakeholder behavior
Failure of control environment of Daewoo shipbuilding & marine engineering Co, Ltd	Lee, Eun, Lee & Park	2019	Asian Case Research Journal	Understand through the Daewoo case how to prevent accounting scandals	The authors believe that companies can learn the consequences of poor corporate governance and should maintain effective control of operations and internal environment
Corporate fraud under pyramidal ownership structure: Evidence from a regulatory reform	Choi, Gam & Shin	2020	Emerging Markets Review	Investigate the relationship between a firm's centrality and its probability of fraud related to intra-group business	During the post-regulatory reform period, the central firms of pyramidal groups showed a drop in corporate fraud with the limitation of their influence on the subsidiaries that somehow managed to prevent the frequency of unfair insider transactions intended to favor the central firm.
Evasive shareholder meetings and corporate fraud	Gam, Gupta, Im & Shin	2020	Journal of Corporate Finance	Proposed that annual shareholder meetings can be linked to corporate fraud when it is evasively scheduled	<ul style="list-style-type: none"> • When executives want to hide some fraud and data, the meeting will probably occur on clustering dates so that the least number of shareholders attend and interfere in the approval of the financial report or the dismissal/election of members of the company's boards, except when this act is considered the common practice of the same industry;

					<ul style="list-style-type: none"> •The authors believe that the electronic voting should be made easier for shareholders who cannot attend meetings to exercise their voting rights.
The future of financial fraud	Karpoff	2021	Journal of Corporate Finance	Study how financial misconduct can change over time, relying on data and existing theories	In the long run, the incidence of financial fraud will decrease, as well as considering that the quality of financial reporting has a directly proportional relationship to the incidence of fraud within a company.
Fraudulent financial reporting: An application of fraud diamond to Toshiba's accounting scandal	Demetriades & Owusu-Agyei	2021	Journal of Financial Crime	How is Fraud Diamond Theory related to Financial Statement Fraud of Toshiba and which issues influenced fraud in the case of Toshiba	<ul style="list-style-type: none"> •It was possible to identify that the set of factors, the pressure of executives to achieve unrealistic results, the weak internal control, and the ability of executives to remove members of company boards; •The relevance of the FDT is proven through all the results obtained by this study, as each variable contributed to determining the value of the Beneish M-score model.
Accounting frauds and main-bank monitoring in Japanese corporations	Sakawa & Watanabel	2021	Journal of Business Ethics	Analyze relationship between bank monitoring and accounting fraud in Japanese companies and its consequences	<ul style="list-style-type: none"> •Accounting fraud is significantly lower in firms with bank relationships, so this may show that banks can replace the audit firms

					control once they appoint an external auditor or director; • There was evidence that firms with lower profitability and higher financial leverage are more likely to commit corporate fraud
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