SPRINGER LINK
Log in
Menu
Search
Cart

Reputations and corporate malfeasance: collusive networks in financial statement fraud

Published: 11 November 2008
Volume 51, pages 365–382, (2009) Cite this article

Crime, Law and Social Change
Aims and scope→
Submit manuscript→

Robert Tillman [1]

1022 Accesses 11 Citations Explore all metrics →

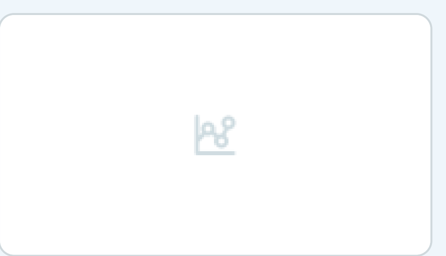
Abstract

The prevailing theory used by economists to explain why more corporations do not engage in fraud focuses on the role of board members, auditors and banks in controlling corporate conduct and the "reputational penalties" that may be imposed on them if they fail to do so. In this view, beyond the formal sanctions imposed by criminal justice and regulatory agencies, these "control agents" are subject to extra-legal consequences for misconduct or failure to perform their duties in which their reputations for honesty and integrity are diminished and thus their value in the marketplace for their services declines. The "reputational penalty" theory has been challenged by recent work that asserts that these entities, far from controlling the behavior of corporate insiders, may form networks of "reputational intermediaries" who collude with corporate executives

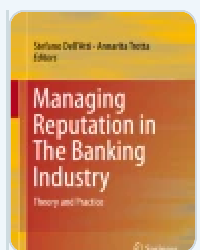
to give legitimacy to their illegal schemes. In this paper, empirical support for the latter view is provided through an analysis of a sample of 374 publicly traded firms that announced financial restatements between 1997 and 2002 and which were accused of securities fraud. The analysis shows that these schemes involved large numbers of board members, auditors, and bankers who aided and abetted senior managers in their attempts to deceive investors. These findings point to broader issues concerning: (1) the changing nature of corporate power; (2) the strengths of collusive networks; and (3) current policy debates regarding attempts to exert more regulatory control over corporate behavior.

This is a preview of subscription content, log in via an institution to check access.

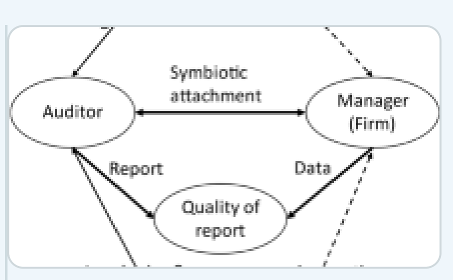
Similar content being viewed by others



Institutions and Corporate Reputation: Evidence from Public Debt Markets



The Case Study of Goldman Sachs



The auditing game: the dark side of the private provision of a public good

Article | 25 January 2022
Chapter | © 2016
Article | Open access
16 November 2023

Notes

1. The Class Action data base often contains numerous lawsuits for each company in the data base. I decided to code the suit designated there as the “Reference Complaint.” These suits often consolidated other suits and were the most comprehensive in scope.

2. Individuals named in administrative actions by the SEC are referred to as “respondents.”

3. The pleading standards for securities fraud cases were raised significantly in 1995 with the passage of the Private Securities Litigation Reform Act. It has been argued that the standard for determining intent in that law, “strong inference that the defendant acted with the required state of mind,” is similar to the “probable cause” standard for making an arrest in criminal cases. [41]

4. Some companies announced more than one restatement. Calculations on investor losses are based on all 400 restatements rather than on a single restatement for each company.

5. Backdating occurs when the dates on which stock option awards are granted are retrospectively altered to maximize the difference between the share price on the award date and the date on which the options can be exercised, thereby increasing the profit to the grantee.

References

1. Agrawal, A., Jaffee, J., & Karpoff, J. (1999). Management turnover and governance changes following the revelation of fraud. *Journal of Law and Economics*, *42*, 309–342.

Article Google Scholar

2. Alexander, C. (1999). On the nature of the reputational penalty for corporate crime: Evidence. *Journal of Law and Economics*, *42*, 489–526.

Article Google Scholar

3. Alexander, J. (1991). Do the merits matter? A study of settlements in class action suits. *Stanford Law Review*, *43*, 497–598.

Article Google Scholar

4. Anderson, M. (2008). Supreme court declines suit brought by enron investors. *Wall Street Journal*, p. A2.January 22.

5. Baker, W., & Faulkner, R. (1993). The social organization of conspiracy: Illegal networks in the heavy electrical equipment industry. *American Sociological Review*, *58*, 837–860.

Article Google Scholar

6. Barlow, H. (2001). From fiddle factors to networks of collusion: Charting the waters of small business crime. In N. Shover, & J. Wright (Eds.), *Crimes of privilege: Readings in white-collar crime* pp. 127–135. New York: Oxford University Press.

Google Scholar

7. Bebchuk, L., Grinstein, Y. & Peyer, U. (2006). Lucky directors. Retrieved on December 18, 2006, from

http://www.law.harvard.edu/programs/olin_center/corporate_governance/papers/lucky_directors.pdf.

8. Beneish, M. (1999). Incentives and penalties related to earnings overstatements that violate GAAP. *The Accounting Review*, *74*, 425–457.

   Article Google Scholar

9. Black, W. (2005). 'Control frauds' as financial super-predators. *The Journal of Socio-Economics*, *34*, 734–755.

   Article Google Scholar

10. Bush, G. W. (2002). Remarks at the marks street senior recreation complex Orlando. *Weekly Compilation of Presidential Documents*, *38*, 1064–1065 June 21.

    Google Scholar

11. Calavita, K., Pontell, H., & Tillman, R. (1997). *Big money Crime: Fraud and politics in the savings and loan crisis*. Berkeley: University of California Press.

    Google Scholar

12. City of New York. (2007). Sustaining new york and the US' global financial leadership. Retrieved on December 22, 2007, from http://www.nyc.gov/html/om/pdf/ny_report_final.pdf.

13. Coffee, J. (2004). What caused enron? A capsule social and economic history of the 1990s. *Cornell Law Review*, *89*, 269–369.

    Google Scholar

14. Columbia Broadcasting System. 60 minutes: Sheriff of wall street.

15. Committee on Capital Markets Regulation. (2006). Interim report of the committee on capital markets regulation. Retrieved on November 30, 2006, from http://www.capmktsreg.org/index.html.

16. Conrad, C. (2004). The illusion of reform: Corporate discourse and agenda denial in the 2002 ‘corporate meltdown’. *Rhetoric and Public Affairs*, *7*, 311–338.

Article Google Scholar

17. Dobbin, F., & Zorn, D. (2005). Corporate malfeasance and the myth of shareholder value. In D. Davis (Ed.), *Political power and social theory* pp. 179–198. New York: Elsevier.

Google Scholar

18. Easterbrook, F., & Fischel, D. (1991). *The economic structure of corporate law*. Cambridge: Harvard University Press.

Google Scholar

19. Eisenberg, T., & Macy, J. (2004). Was arthur andersen different? An empirical examination of accounting firm audits of large clients. *Journal of Empirical Legal Studies*, *1*, 263–300.

Article Google Scholar

20. Fama, E., & Jensen, M. (1983). Separation of ownership and control. *Journal of Law and Economics*, *26*, 301–325.

Article Google Scholar

21. Granovetter, M. (1973). The strength of weak ties. *American Journal of Sociology*, *78*, 1360–1380.

Article Google Scholar

22. Greenhouse, L. (2008). Supreme court limits lawsuits by shareholders. *New York Times*, p. c1. January 16.

23. Greenspan, A. (1967). The assault on integrity. In A. Rand (Ed.), *Capitalism: The unknown ideal* pp. 112–116. New York: New American Library.

Google Scholar

24. Karpoff, J. (2002). Why reputation counts more than regulation: Criminal penalties are not the way to prevent more enrons. *The European Business Forum*, *9*, 78–79.

Google Scholar

25. Karpoff J., Lee, D., & Martin, G. (2006). The costs of cooking the books. Retrieved on November 21, 2006, from http://leeds-faculty.colorado.edu/Bhagat/CostofCookingTheBooks.pdf.

26. Kedia, S., & Philippon T. (2006). The economics of fraudulent accounting. Retrieved on December 21, 2006, from http://papers.nber.org/papers/W11573.

27. Kinney, W., & McDaniel, L. (1989). Characteristics of firms correcting previously reported quarterly earnings. *Journal of Accounting and Economics*, *11*, 71–93.

Article Google Scholar

28. Kramer, R., Michalowski, R., & Kuzlarich, D. (2002). The origins and development of the concept and theory of state-corporate crime. *Crime & Delinquency*, *48*, 263–282.

Article Google Scholar

29. Krippner, G. (2005). The financialization of the american economy. *Socio-Economic Review*, *3*, 173–208.

Article Google Scholar

30. Labaton, S. (2007). S.E.C. seeks to curtail investor suits. *New York Times*, p. C1.February 13.

31. Macy, J., & Sale, H. Observations on the role of commodification, independence, and governance in the accounting industry. *Villanova Law Review*, *48*, 1167–1188.

32. McLean, B. (2001). Is enron overpriced? *Fortune*, p.122.March 5.

33. Michalowski, R., & Kramer, R. (1987). The space between laws: The problem of corporate crime in a transnational context. *Social Problems*, *34*, 34–51.

Article Google Scholar

34. Norris, F. (2007). Is fraud O.K., if you help just a little? *New York Times*, p. c1.

35. Phillips, K. (2008). *Bad Money: Reckless Finance, Failed Politics and the Global Crisis of American Capitalism*. New York: Viking.

Google Scholar

36. Prentice, R. (2000). The case of the irrational auditor: A behavioral insight into securities fraud litigation. *Northwestern University Law Review*, *95*, 133–219.

Google Scholar

37. Public Broadcasting System. Frontline: The wall street fix. Interview, eliot spitzer. Retrieved on February 22, 2004, from http://www.pbs.org/wgbh/pages/frontline/shows/wallstreet/interviews/spitzer.html.

38. Reed, G., & Yeager, P. (1996). Organizational offending and neoclassical criminology: Challenging the reach of a general theory of crime. *Criminology*, *34*, 357–387.

Article Google Scholar

39. Sutherland, E. (1945). Is 'white-collar crime' crime? *American Sociological Review*, *10*, 132–139.

Article Google Scholar

40. Tappan, P. (1947). Who is the criminal? *American Sociological Review*, *12*, 96–102.

Article Google Scholar

41. Tellabs, Inc., et al. v. Makor issues & rights, LTD., et al., No. 06–484 U.S. Lexis 8270.

42. Tillman R. (Forthcoming). Making the rules and breaking the rules: The political origins of corporate corruption in the new economy. *Crime, Law and Social Change*.

43. Tillman, R., & Indergaard, M. (2007). Control overrides in financial statement fraud: A report submitted to the institute for fraud prevention. Available at http://www.theifp.org/research%20grants/recentStudies.html.

44. Tillman, R., & Indergaard, M. (2007). Corporate corruption in the new economy. In H. Pontell, & G. Geis (Eds.), *International Handbook of White-Collar and Corporate Crime* pp. 474–489. The Netherlands: Springer.

Google Scholar

45. Tillman, R., & Indergaard, M. (2005). *Pump and dump: The rancid rules of the new economy*. New Brunswick: Rutgers University Press.

Google Scholar

46. U.S. General Accountability Office (2006). Financial restatements: Update of public company trends, market impacts, and regulatory enforcement activities. GAO-06–678. Washington: U.S.G.P.O.

Google Scholar

47. U.S. General Accounting Office (2003). *Financial statement restatement database. GAO-03–395R*. Washington: U.S.G.P.O.

Google Scholar

48. U.S. General Accounting Office (2002). *Financial statement restatements: Trends, market impacts, regulatory responses, and remaining challenges*. *GA0–03–138*. Washington: U.S.G.P.O.

Google Scholar

49. U.S. Senate Committee on Banking, Housing, and Urban Affairs. Federal reserve's second monetary policy report for 2002. 107th Cong. 2002.

50. U.S. Senate Committee on Governmental Affairs. The watchdogs didn't bark: Enron and the wall street analysts. 107th Cong. 2002.

51. Williams, P. (2002). Transnational criminal networks. In J. Arquilla, & D. Ronfeldt (Eds.), *Networks and netwars* pp. 61–97. Santa Monica: Rand Corporation.

Google Scholar

52. Wu, M. (2002). Earnings restatements: A capital market perspective. Dissertation, New York University.

53. Zey, M. (1999). The subsidiarization of the securities industry and the organization of securities fraud networks to return profits in the 1980s. *Work and Occupations*, *26*, 50–76.

Article Google Scholar

54. Zorn, D. (2004). Here a chief, there a chief: The rise of the CFO in the american firm. *American Sociological Review*, *69*, 345–364.

Article Google Scholar

Acknowledgements

The research reported here was supported by a grant from the Institute for Fraud Prevention. Points of view expressed in this document are the author's and do not necessarily represent the position of the Institute for Fraud Prevention.

Author information

Authors and Affiliations

Dept. of Sociology, St. John's University, Jamaica, NY, 11439, USA

Robert Tillman

Corresponding author

Correspondence to Robert Tillman.

Rights and permissions

Reprints and permissions

About this article

Cite this article

Tillman, R. Reputations and corporate malfeasance: collusive networks in financial statement fraud. *Crime Law Soc Change* **51**, 365–382 (2009). https://doi.org/10.1007/s10611-008-9161-1

Published
11 November 2008

Issue Date
April 2009

DOI
https://doi.org/10.1007/s10611-008-9161-1

Keywords

Stock Option
Audit Firm
Corporate Executive
Corporate Crime
Accounting Firm

Search

Search by keyword or author

Navigation

Find a journal

Publish with us

Track your research