

# **Thesis Evaluation for DBA Candidate, Asuka Takaoka**

DBA Thesis Title

## **A Mixed Methods Analysis of Root Causes of Corporate Frauds in Japan: Board Composition and Internal Power Factors**

July 8, 2020

ICS DBA Candidate, Asuka Takaoka has successfully completed her thesis defense on May 19, 2020. The Thesis Committee concludes that Asuka Takaoka's thesis has fulfilled the requirements for the DBA degree and recommends to grant her Hitotsubashi University's doctoral degree in business administration. Below is a summary of this thesis, followed by the Committee's evaluation and conclusion.

### **1. Overview of the Thesis**

The thesis sheds light on the implicit, internal, and informal factors associated with the occurrence of corporate frauds to uncover the entire picture of these frauds from the inside and the outside. Until recently, corporate frauds have been mainly examined in relationship with explicit, external, and formal factors such as board composition, percentage of outside directors and/or independent chairmen, committee structure, and company performance. The thesis fills the gap in the literature using a mixed method approach, i.e., an effective integration of quantitative study/analysis and qualitative study/analysis. More specifically, the thesis uses the explanatory order approach (vs. exploratory order approach) where a quantitative study is conducted first followed by a qualitative study.

In the thesis, quantitative analysis is used to empirically test whether board homogeneity can affect the occurrence of frauds in companies listed in the first section of the Tokyo Stock Exchange. The results of panel regression analyses performed between 2015 and 2019 indicate that an increase in the proportion of lifetime directors (i.e., those who joined the company as fresh graduates) significantly associates with an increase in the frequency of corporate fraud occurrence, while an increase in the proportion of outside directors has no significant impact on the decrease in the fraud frequency. Moreover, board homogeneity is shown to negatively affect board decision-making on dealing with frauds and eventually increase their occurrence frequency, particularly in the case of organizational frauds.

To better understand the mechanism of the occurrence of frauds in companies, a systematic qualitative study was designed and conducted. Qualitative analysis of 133 third party reports on corporate frauds identified four categories of internal power factors (*position power, informal power, perceived power, and neglect*) and revealed how they can strengthen each factor of the so-called fraud triangle (*opportunity, pressure, and rationalization*) to promote the occurrence of frauds and their concealment.

## **2. The Thesis Committee's Evaluation**

This thesis has successfully fulfilled DBA research requirements: the research is grounded both in practice and in academia, investigates and addresses an important managerial issue with solid academic research methods, and makes theoretical contributions to the management and organization research and provides sufficient managerial implications.

### ***Theoretical Contributions***

This research quantitatively and qualitatively examined corporate frauds in Japan from multiple aspects to uncover the phenomena as well as their mechanism, and made the following three major theoretical contributions.

First, quantitative analysis introduced new explanatory variables, and the obtained results suggested that internal directors matter more than outside directors when it comes to the likelihood of corporate fraud occurrence in Japan, further showing that board homogeneity as a proxy of the higher percentage of lifetime directors is positively correlated with the occurrence of corporate frauds. These findings support the behavioral agency model with particular emphasis on internal governance, helping to predict relationships between frauds and board composition. With these findings in hand, the behavioral agency model could be extended.

Second, quantitative analysis further revealed significant differences in fraud ratio across industries, demonstrating that the highest ratios were observed for the four secondary-sector industries (electricity & gas, automobile & aircraft, transportation & logistics, and construction & materials).

Third, qualitative content analysis of 133 third-party committee reports identified a new set of internal power factors associated with fraud occurrence, namely position power, informal power, perceived power, and neglect. In turn, these factors featured the contributions of 11 internal power factors, namely orders, vertical relationships, horizontal power imbalance, intra-

company relationships, sales/profit supremacy, “customer is always right” perception, excessive error-free policy, non-intervention policy, government/organization failures, lack of knowledge and interests, and intentional neglect. Additionally, the mechanism behind corporate frauds was uncovered as an extended implication of the fraud triangle model, which has not yet been discussed. In summary, when several internal power factors come together, the individual fraud triangle factors are strengthened to generate undeniable forces that can eventually lead to frauds. Furthermore, once frauds happen, this combined group of power factors pushes companies into making organizational decisions to conceal their frauds for a certain period. Thus, as a mechanism, power-related behaviors can affect not only organizational frauds, but also their subsequent organizational concealments, if these behaviors come together.

### ***Managerial Implications***

This work revealed the issues of board homogeneity, particularly the lifetime director percentage, and informal power factors associated with frauds. In the past years, particularly since the Corporate Governance Code has been enacted, the listed companies made tremendous efforts to prepare for a formal governance structure by inviting outside directors and outside auditors, establishing remuneration and nomination committees, and redesigning governance structure. By 2020, most companies have taken actions to strengthen their governance mechanism through explicit, external, and formal measures. Now it is time to move to implicit, internal, and informal aspects, particularly when it comes to corporate fraud prediction and prevention. The results, analysis, and discussion in this thesis have important managerial implications for the top management of Japanese companies and broader stakeholders, triggering them to further increase board diversity and directly tackle the list of power factors, thereby strengthening governance in a real sense and eventually helping to prevent frauds.

### ***Limitations and Further Development***

As any piece of research, this thesis has limitations. Some of these are areas that can be further developed and improved as the thesis is revised for publication in academic journals. Others offer starting points for new research. Since a detailed discussion of its limitations and an extensive list of future directions are provided in the thesis, we selectively mention only major limitations and further development/future directions here.

Regarding the quantitative analysis, more sophisticated estimation model could be used. For example, development of a multinomial logit model with repeated-measure could be

considered and explored to increase the rigor. In addition, further exploration about board diversity indicators might add insights. Examples include the number of different expertise of directors, the ratio of directors with overseas working experiences, the ratio of female and/or foreign nationality directors. Another dimension that might affect frauds would be directors' commitment level toward the board decision-making activities, which could be quantified by such proxies as attendance rate of directors, the number of comments at board meetings, the number of directors' communications with the employees.

As for qualitative analysis, validation process could be further strengthened. One way is to have external, independent coders who are not informed of anything about the research details to do coding objectively in order to increase the coding accuracy and validity. As a future direction, a large-scale interview with outside directors of fraud companies (or veteran outside directors of any listed companies if it is too difficult) seems promising to complement the current qualitative results and further explore the fraud mechanisms.

### ***Conclusion***

The Thesis Committee concludes that Asuka Takaoka's thesis has fulfilled the requirements for the DBA degree and by successfully conducting this research he has demonstrated her qualifications as an academic scholar. The Committee therefore recommends to grant Asuka Takaoka Hitotsubashi University's DBA degree.

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