THE ANNOUNCEMENT EFFECT OF WHITE COLLAR CRIME ON STOCK PRICE BY PUBLIC LISTED COMPANIES IN MALAYSIA

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THE ANNOUNCEMENT EFFECT OF WHITE COLLAR CRIME ON STOCK PRICE BY PUBLIC LISTED COMPANIES IN MALAYSIA

By

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This project is submitted in partial fulfillment of the requirement for the Corporate Master in Business Administration (CMBA) programme

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Statement of Originality

The work described in this Corporate Business Project, entitled “THE ANNOUNCEMENT EFFECT OF WHITE COLLAR CRIME ON STOCK PRICE BY PUBLIC LISTED COMPANIES IN MALAYSIA” is to the best of the author’s knowledge that of the author except where due reference is made.

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ABSTRACT

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Since twentieth century, white collar crime has been present and become a widespread problem in the public. Nowadays, the growing of white collar crimes cases had pose much challenges toward enforcement agencies especially in developing countries such as Malaysia. Therefore, the share price event study is an important part of financial economics that can help researchers attempt to illustrate the impact of an event on firm’s stock returns. This study uses an event study methodology to examine the announcement effect of white collar crime towards the public listed firm on stock’s performance in Malaysia. The sample consists of 17 public announcements by 16 established public companies charged by Securities Commission for committing the white collar crime from the period of 1996 to 2013 in Malaysia. In this study, the daily basis of Average Abnormal Returns (AARs) and Cumulative Average Abnormal Returns (CAARs) with an event window of 90 days prior to and after the announcements has been determined. The finding indicates that an announcement of white collar crime has negative abnormal return on share price. As the result, the market does not reacting efficiently towards the information released regarding the incidence of white collar crime.
ABSTRAK

KESAN PENGUMUMAN JENAYAH KOLAR PUTIH TERHADAP HARGA SAHAM OLEH SYARIKAT AWAM TERSENARAI DI MALAYSIA

Oleh
Tay Liang Mui

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CHAPTER 1
INTRODUCTION

1.1 Overview

Since twentieth century, white collar crime has been present and become a widespread problem in the public. This crime is known as non-violent and illegal act that are committed by someone typically for their organization or personal gain. The concept of white collar crime can be defined in many different ways which depend on the context and perspective. Within the field of criminology, the idea of “white collar crime” has been first coined by sociologist Edwin Sutherland in 1939 at the American Sociological Meeting. Sutherland is a pioneer in his study of white collar crime. He defined white collar crime as a “crime committed by a person of respectability and high social status in the course of his or her occupation” (Payne, 2012, p. 35). However, this original definition of Sutherland has been criticized in term of not excluded violence act and also not differentiated between corporations and individuals (Benson and Simpson, 2009). Therefore, Sutherland (1983) point out his response to these criticisms, by arguing that violence acts such as adultery, intoxication and murder are excluded because these acts do not form in the occupation of the upper class. Further, he explained that this crime can be describes as non-violent crimes committed by individuals such as business managers and executives in the course of their business activity (Sutherland, 1983).
In contrast to Sutherland definition, another criminologist Herbert Edelhertz who specialized in the study of white collar crime defined the crime as:

“an illegal act or series of illegal acts committed by non-physical means and by concealment or guile for the purpose of obtaining property or money, to avoid paying money or losing money or property, or to gain personal or business advantages” (Edelhertz, 1970, p. 3).

However, Henning (2009) noted that white collar crime might be defined as financial crime against property of someone else committed by white collar criminals for organizational or personal gain. Another definition of white collar crime has been defined by the Federal Bureau of Investigation (FBI) as “illegal acts which are characterized by deceit, concealment, or violation of trust which are not dependent upon the application or threat of physical force or violence” (United States (US) Department of Justice, 1989, p. 3). In addition, criminologists who work in this study area have denoted a variety of white collar offences and can be used interchangeably with the term such as economic crime, business crime, corporate crime, commercial crime and financial crime. Within this definition, it is clearly stated that white collar crimes comprise a wide types of offenses such as larceny, espionage, fraud, kickbacks, embezzlement and regulatory violations.

Nowadays, white collar crime continues to rise in the worldwide. In 2013, Afghanistan, North Korea and Somalia are the most corrupted countries among the 177 countries in the world. As mentioned in the Transparency International’s Corruption Perception Index (2013), the score for these countries were reported as 0.8 out of 10 in which the lower the score, the higher the perceived level of corruption in
the country. As comparison, US ranked 19th and China ranked 80th with the score of 7.3 and 4.0 respectively. However, Friedrichs (2009) found that white collar criminals wreak havoc in the finances in US which estimated to suffer economic damages about $250 billion to $1 trillion every year.

Yu (2008) pointed out that China is the most populous country that involved in both unprecedented economic development and rampant corruption in all levels of government and private sector among the developing countries. Previous studies found that there are two main reasons for the incidence of white collar crime in China as to how it still maintain under a cloak of official secrecy; first, government does not like to broadcast their country image riddled with upper class law breaking and second, the government officials may involved in those illegal activities and would not desire to alert the wrongdoing in other high places to the public (Pontell and Geis, 2010). In addition, Ghazi-Tehrani, Pushkarna, Shen, Geis, and Pontell (2013) noted that the major problems in China are business offenses such as fraud against citizens as well as domestic and international consumers, environmental crime and government crime.

According to Hilb (2008), corporate accounting scandal in US such as Enron, Global Crossing, Tyco, HealthSouth, WorldCom and Adelphia were companies that experience a serious stock market collapse caused by corporate and white collar crimes of non-middle class. The findings of Lanfranconi and Robertson (2002) on Enron and WorldCom highlighted that these firms collapse due to the board member’s lack of knowledge on financial and accounting issues including basic accounting (Volpe and Woodlock, 2008). Moreover, the occurrence of accounting scam such as
Satyam Computer Services Ltd in India in 2009 was due to auditor’s reported inaccurate and unreliable information to the public (Gakhar, 2014) and was under the owner’s influence (Van Tandeloo and Vanstraelen, 2008). In addition, Sanyal and Samanta (2011) notes that white collar crimes account for about 40 percent of the total cost of crime in which it is estimated to cost about upwards of $8.5 billion each year to the Australian Government.

White collar crime continued to appear as the hot topic in Malaysia and it is a serious problem in our society. According to Transparency International’s Corruption Perception Index (2013), Malaysia ranked 53rd (tied with Turkey) out of 177 countries in 2013 with the score of 5 out of 10. In other word, it means the higher the score, the lower is the perceived level of corruption in the country. Liew and Puah (2011) pointed out those companies in Malaysia such as Kenmark Industrial Co (M) Berhad, Alliance Financial Group Berhad, and Sime Darby Berhad had faced the decline in stock price due to the announcement of authority abuse and suspected of fraud. In today’s competitive business environment, corporate crime is consider as one of the most powerful hindrances to the economic development of a country (KPMG, 2013). It also causes an unfavorable business environment and encompasses such offense as fraud, insider trading, healthcare fraud, forgery, computer crime, tax evasion and embezzlement also known as criminal breach of trust in Malaysia.

In addition, white collar crimes also resulted in negative societal impacts in which it leads to an increase in the public awareness and decrease the level of confidence between investor and consumer (Ivancevich, Thomas, Jacqueline and Gilbert, 2003). However, in the study carried out by Wright, Cullen, and Blankenship (1995) argued
that corporate crime can be divided into many categories which comprise kickbacks, commercial bribery, price fixing, fraud against government, tax violations and crimes among consumers. Based on the survey done by KPMG (2013), the most common types of corporate frauds were theft of outgoing funds (67%), theft of physical assets (58%) followed by theft of incoming funds (34%). In addition, a report by PricewaterhouseCoopers (2014) reported that those economic crimes such as asset misappropriation, procurement fraud, corruption and bribery, cybercrime and accounting fraud are considered as the most common crimes that occurred in Malaysia. The announcement effect of white collar crime may cause most of the organization to suffered losses and adverse effect on the stock price as well as led to economic damages of the country.

1.2 Background of the Study

White collar crime is pervasive and growing in Malaysia today. In Malaysia, the Royal Malaysian Police (RMP) play important responsibility to investigate white collar crime cases such as fraud, cheating scams, criminal breach of trust and misappropriation of funds that is vested in Commercial Crime Investigation Department (CCID). According to CCID, the amount losses through embezzlement, scams, criminal breach of trust and other white collar crimes exceed RM1.775 billion in 2013 (Mohamed, 2014). Fortunately, based on CCID investigation, the total number of white collar crime cases has dropped 9.4% from 18,386 cases in 2012 to 16,661 cases in 2013, but the amount of losses was surged by more than RM155.95 million. As reported by CCID, the highest amount of losses due to white collar crime was involved RM943 million in Kuala Lumpur with 2,279 cases, followed by RM281
million in Selangor with 3,248 cases and then, RM108 million in Perak with 1,294 cases (Mohamed, 2014).

The global expansion of information system and technological advancement have contributed to the growth of white collar crime and become a bigger problem in today’s society than in the past decade. Since Malaysian society has modernized, these criminals behavior become increasingly sophisticated, organized and systematic with the post 1990s era experienced the changes in the trend and modus operandi of white collar crime (Lim, 2005). Generally, these changes occurred due to the changes in demographic shifts, economic and technological forces, as well as society aging such as higher level of education. These criminals adopt highly in specialized activities such as “high-tech cheque scams” (cloning of cheques by Melaka and Penang State Governments), share scams, ATM/credit card frauds, internet fraud, “Flight by Night” scams and money laundering (Lim, 2005). As technology advances, a new type of crime has been created through the internet and in turn, increased the occurrence of corruption particularly in large companies. In order to raise the society awareness of white collar crime, the law enforcement agencies should have more education about white collar criminals to minimize the occurrence of this crime (Williams, 2006).

Furthermore, white collar crime of the 21st century is nearly unpreventable and hard to prosecute as well as strikes ordinary citizens and celebrities alike (Bob Sullivan, 2004). Bribery and fraud cases involving companies in Malaysia are also on the rise. According to Lomax (2003), those companies had performed fraudulent accounting activities in their financial reports in order to falsify their financial statements. A
A survey done by KPMG over 100 public listed companies found that 40% of the respondents had committed fraud because they want to maintain a certain lifestyle that they have chosen. The findings of KPMG revealed that those companies who had experienced fraud as a result of lack of skill sets to detect fraud, lack of supervision such as poor internal control and lack of awareness training to detect red flags (Sidhu, 2014).

Since 1 January 2005, CCID has expanded through additional manpower and allocation of equipments in order to strengthen its capability in the process of eradicating white collar crimes. Consequently, CCID will work together with other institutions or agencies to combat white collar crimes. Other than that, Forensic Computer Laboratory has been established by the police to assist investigating officers in computer crime cases. Furthermore, the police have mounted several operations to prevent further losses in billions of ringgit toward criminal syndicates such as land fraud, product piracy, computer fraud, credit card fraud and money laundering. In order to lower the crime rates, all state police will cooperate with trade associations and banks to come up with new initiatives and effective methods with the necessary skills to prevent white collar crime in 2011 (Cops to Combat White Collar Crime, 2010).

After the incidents of both Asian Financial Crisis 1997 and mortgage crisis 2008, it exposed the extent of white collar crimes committed by those financial institutions in Malaysia. As reported by CCID, white collar crime in Malaysia has increased dramatically to 10,390 cases in 1998 and make a huge losses of RM4,600 million, as compared to 4,386 cases in 1992 with the amount of losses about RM153.08 million.
Lim, 2005). In order to reduce the opportunities commitment of white collar crimes, a good corporate governance and framework has been established by Malaysian government through forming a committee. For example, the Companies Commission of Malaysia (CCM) is the body that has jurisdiction over the Companies Act in Malaysia and act as a member of Special Task Force on Prevention of White Collar Crime to handle all white collar activities in which include deposit taking and illegal investment, fund manipulation, money laundering and so forth. Overall, the main purpose of this study is to examine the effect of white collar crime activities charged under Securities Commission (SC) toward public listed companies in Malaysia over the period from year 1996 until year 2013 by using established event study methodology.

1.3 Rationale for the Study

Since Malaysia society has been modernized, together with the rapid growth of population lead to the white collar crime widespread across the nation. In Malaysia, the crime rates have been on an increase trend since 1973 (Habibullah and Baharom, 2008). According to the survey report done by KPMG (2009) revealed that the level of fraud occurrence is expected to rise in Malaysia especially in public sector. As reported by KPMG (2013) stated that the fraud perpetrated by non-management employees has been increased dramatically from 34 percent in 2009 to 50 percent in 2013. All these findings will show that fraud has such a detrimental effect toward company in Malaysia in which creates an unfavorable business environment especially the public confidence in the fairness of the capital.
In addition, Sutherland (1983) outlined that the consequence of white collar crime undermine public confidence will result in serious damages to financial institutions and economic performance, as well as generated social disorganization and lowers social morale. For instances, when the consumer confidence decreases, it will lead to increase in social disorganization since the societal consequences are connected to one another. Apart from that, the foreign and local investors would have less faith in societal values of the country. As mentioned previously, accounting scandals such as HealthSouth, WorldCom, Enron and Tyco have experienced a dropped in the credit rating of their debt issues and shaken the confidence level of investors due to their stock prices dramatically plummeted (Agrawal and Chadha, 2005). Therefore, it is very important for Malaysia’s corporate to know how the stockholder is going to drive down the share price of the company when they committed in the crimes. These share price reaction toward the announcement effect of white collar criminal offenses committed in Malaysia are seen to be deterrent in nature. Therefore, the main objective in this research is to empirically examine the effect of announcement of white collar crime towards public listed company on their stock’s performance in Malaysia over the periods 1996 to 2013.

Furthermore, the purpose of the present study is aimed to understand more about the causes of white collar crimes. It is very important to increase awareness and education about the concept of white collar crimes in universities and other educational setting (Martinez, 2014). This is because many people are not aware of the extent of white collar crime damaging our society. However, it is possible that lack of awareness and education would prohibit the public from understanding how they are being victimized (Martinez, 2014). In this context, it provides greater insight for students,
criminologists, policy maker and the members of the society about all categories of white collar crime and variations of criminal behavior. An effective prevention has raised the awareness of individuals in order to reduce the opportunities committed in white collar crimes. The stakeholders should be more educated about white collar crime in order to help generate critical thinking skills and base of awareness to combat white collar crime within Malaysian businesses.

1.4 Problem Statement

The dilemma of white collar crime is a continuous plague in Malaysia as well as other developing countries. According to the report done by Global Financial Integrity (GFI) (2013) revealed that the illicit financial flows from developing world in 2011 was recorded about US$946.7 billion as compared to US$832.4 billion in 2010. The cumulative illicit financial outflows from the developing countries over the period 2002 – 2011 recorded an average rate of illicit outflows was more than 10 percent per year with average of US$5.9 trillion outflows. These illicit financial outflows from the developing countries are come from the sources such as corruption, tax evasion, crime and other illicit activity. In term of the largest cumulative illicit financial outflows over the period 2002 – 2011, Malaysia is ranked the fourth across all the developing countries with the illicit outflows of US$370.38 billion (GFI, 2013). Malaysia is ranked the third after Russia with illicit outflows of US$880.96 billion among all the developing countries in Asia. However, China was ranked first out of 144 developing countries with their cumulative illicit financial outflows of US$1.08 trillion over the period 2002 – 2011 (GFI, 2013).
In Malaysia, white collar crime particularly in fraud, corruption and bribery is the most serious problem for those businesses. Based on the survey report done by KPMG (2013), 48 percent of survey respondents in which represent 14 industry segments indicated that the occurrence of fraud in their organization over the period from 2010 to 2012. As compared to 2009, 49 percent of the survey respondents admitted to fraud over the period from 2006 to 2008 in which means the occurrence of fraud has slightly decreased by 1 percent and it is still considered as a significant problem to all Malaysian businesses. KPMG (2013) found that the amount losses of fraud was recorded as RM2.407 million and KPMG (2013, p. 25) only 50 percent of survey respondents are not willing to pay the full amount of misappropriated assets.

Empirical evidence on the survey done by GFI (2013) and KPMG (2013) indicated that the levels of white collar crime occurrences are widespread in Malaysia. As reported by CCID the white collar crime cases such as cheating, fraud, misappropriation of funds and criminal breach of trust that was investigated by police in Malaysia was involved in 10,857 cases with losses amounted to RM1,125.60 million in 2002. According to Gilbert (2013), the number of white collar crime cases in 2011 was reported 22,033 cases with amount of losses approximate to RM1.1 billion. Many researchers claimed that white collar crimes are not violent crime as compared to other form of crime. But, it cannot be denied that the extent and impact of white collar crime are very harmful to society. Instead of assessing financial losses on business and society, the victims of white collar crime may suffer huge ripple effect such as emotional impact, psychological and as well as physical harm (Kempa, 2010).
Based on the Canadian Securities Administration (CSA), victims of white collar crimes especially those who lost more than $10,000 (Tomlin, 1982; Levi and Pithouse, 1992; Shover, Fox, and Mills, 1994; Shichor, Doocy, and Geis, 1996) faced high levels of stress, anger, depression, and isolation (Kempa, 2010, p.253). Furthermore, a study carried out by Spalek (2001) claimed that many victims were unlikely to trust financial institutions or organizations since they have lost their pension fund due to fraudulent investment scheme. Apart from that, physical harm also contributes to health problems to human beings such as disabling injury, illness and premature death that result from white collar crime (Payne, 2012).

The statistics were collected based on the victims of white collar crimes report victimization has aimed the researcher to find the range of consequences associated with white collar crime (Friedrichs, 2009). It is very difficult to estimate the occurrences and exact cost of white collar crime, but it could be explained by “the reasons why white collar crime victimization is not inspire the same concern level as well as conventional crime victimization. As mentioned previously, GFI (2013) and KPMG (2013) shown that white collar crime has been flourish in Malaysia which seriously affects the overall economy. The extent of white collar crime can cause much irreversible damage to our society especially the reputation of the listed companies in Malaysia and the country image as a whole. As a result, the foreign investors are not encouraged to take part in their capital allocation of the country.
1.5 Objectives of the study

1.5.1 General Objective

The main purpose of this study is to investigate the effect of announcement of white collar crime towards the public listed firm on stock’s performance in Malaysia. This study aims to analyze the responds of stock market to the announcement due to white collar crime in the companies.

1.5.2 Specific Objective

This research consists of three specific objectives as shown as below:

i. To empirically examine the stock price reaction to the announcement effect as a result of white collar crime in Malaysia;

ii. To determine the existence of abnormal returns on announcement dates of white collar crime;

iii. To identify the efficiency level of stock market in Malaysia.

1.6 Significance of the Study

In today’s competitive business environment, the growing of white collar crimes cases have poses the challenges toward enforcement agencies especially in Malaysia that cope with scarcity resources. In order to combat white collar crimes, the share price event study is an important part of financial economics which can help researchers attempt to illustrate the impact of an event on stock returns of the company. Many researchers have used this method to identify the possibility of an unanticipated event that could result in abnormal stock price in financial market. Therefore, the findings from this study will strengthen our understanding of how the given type of information that related to a particular aspect of corporate behavior will affect security’s price and impact of events toward investor wealth. If the events study
produce abnormal movement in the stock price, this mean that this study has strong impact on the financial performance of firm’s value.

Stockholder punishes unethical companies that their workers partake in unethical behavior for their personal benefit in order to maximize their profit and get juicy contract. This can be important deterrent effect on share price reaction toward immoral behavior that can lead to a drop in share price. When the crimes made known to the public, investors would be unwilling to buy the shares from the companies due to dishonesty in transact business. As a result, this study can further enrich the research through understanding how the announcement effect of white collar crime is going to affect the share price. It may raises the concern among stakeholders especially directors and owners about the crucial to keep a healthy condition in their corporation and motivate the firm’s owner to operate their companies more efficiently.

Moreover, this study aims to encourage the investor attention towards corporate governance issue especially in public listed companies. The growing importance of reliable corporate reporting enables the company to raise corporate image and also increase public confidence. Previous studies emphasized that the dominant power of the controlling shareholders in Asian countries is the cause for the ineffective corporate governance. In addition, this study provides a better understanding about the causes of white collar crime for stakeholders by creating more programmes. However, it is very important to raise the stakeholder’s awareness and help them to minimize the opportunities to commit white collar crime within organization. With this knowledge, the stakeholders become more informed and educated, in turn able to reduce the white collar crime cases in Malaysia.