

# Exploration of nexus between legal liability and corporate fraud: where do business laws and criminology converge?

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# Exploration of nexus between legal liability and corporate fraud: where do business laws and criminology converge?

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## Abstract

Corporate fraud has emerged as one of the main issues in today's corporate world, which largely impact the performance and credibility of the associated companies. It has been observed that many stakeholders, shareholders and investors often face serious financial and social damages due to different fraudulent activities such as deception of financial transactions and statements. Corporate fraud is not only observed in developed countries, but many developing countries suffer from persistently increasing numbers of fraudulent activities in their corporate sector. Similarly, corporate fraud is persistently increasing; therefore, this study has focused on determining the association between legal liability and corporate fraud in Indonesia. Thus, qualitative legal research was conducted to determine the legal framework of corporate fraud in Indonesia. For this purpose, the data was collected from different primary and secondary sources, including laws, regulations, legal documents, books, articles, and other related material. The results obtained from this study showed that no effective legal framework in Indonesia specifically focuses on corporate fraud. However, individual fraud has been highlighted under the "Panel Code" (KUHP). Therefore, a few other regulations by the "Indonesian Financial Services Authority," also known as "Otoritas Jasa Keuangan" (OJK), expanded to corporate fraud. Other laws which have been developed in Indonesia within the context of corporate criminal liability include "Anti-money laundering Law," "Anti-corruption law," "Law No. 31 the Year 1999 regarding the Eradication of the Criminal Act of Corruption" and others. Thus, this study has also effectively provided different recommendations to improve the legal liability of corporate fraud in Indonesia. This study also provides different theoretical and practical implications within the context of the legal liability of corporate fraud.

Keywords: Corporate Fraud; Indonesia; Legal Liability; Business Laws; Criminology

## 1. Introduction

Corporate fraud occurs when a business purposefully falsifies facts to strengthen its place in the marketplace. It may also occur when a company employee deceives

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the company by stealing money, engaging in corruption, or misrepresenting expenses in order to benefit financially. The Report of the Nation's 2016 Global Fraud Survey found that, on average, fraud costs an organization 5% of its annual sales (Satapathy, 2022). Corporate responsibility in criminal law establishes the scope of a corporation's legal liability for the conduct and errors of the individuals who it employs. It is frequently seen as a component of criminal vicarious liability, as opposed to situations where the language of a statute specifically holds a firm accountable as the principal or associated principal with an individual agent (Khajanchi, 2023). Corporate criminal liability may be seen as a crime committed by a single person or collection of people who engage in particular deeds or omissions that are against the law or that they know to be wrong but do so for the benefit of a company, group of people, or other entity with the common goal of getting business while at work. In Indonesia, corruption is a big issue. Indonesia is familiar with laws creating corporate criminal responsibility, among which are based on tax fraud, financial fraud, banking fraud, as well as in cases of corruption. Execution, nevertheless, has not been performed well.

Certain laws, in particular the Anti-Corruption Law and the Anti-Money Laundering Law, establish specific regulations on when a firm may be held liable for an offense recognized as corporate criminal liability. According to Anti-Corruption Law's Article 20, an organization may be held accountable for fraud if a crime is carried out by individuals who are operating on behalf of the firm due to an employment contract or another arrangement. The Indonesian Supreme Court issued Regulation No. 13/2016 about Rules for Dealing with Criminal Activities committed by Companies at the end of 2016, which states that an organization must be represented throughout any investigation and afterward trial for corporate offenses committed by any member of its executive team (Due Diligence, 2023).

The numerous reported corruption cases involving different authorities at the central and regional levels serve as proof that fraud has become widespread in Indonesia. The appropriateness of employee compensation can encourage workers to perform their tasks properly and effectively and reduce fraud (Wahyudi, Achmad, & Pamungkas, 2022). A thorough research of the connection between company law and criminology in the setting of Indonesia is required due to the important nature of the nexus between legal liability and corporate fraud. The reliability of the Indonesian economic system continues to face substantial problems from cases of corporate fraud regardless of the legal and regulatory frameworks that are currently in operation.

Fraud is one such cost that is underemphasized. Even when breaching the law would be more costly from the perspective of the firm than it would be beneficial, managers who hold a small percentage of the shares may be ready to do it in order to gain themselves (Dyck, Morse, & Zingales, 2023). While the corporate sector cannot guarantee economic stability, it does play an integral part in every nation's development. Corporate criminality poses a severe threat to society's well-being because of how many people it impacts and how much it covers every aspect of social and communal life. Corporate companies are, therefore, in a position to seriously impact people's lives and the economy (Kally, 2020). The aim of this study is to examine and understand how legal liability and corporate fraud relate, with an

emphasis on bridging the criminology and business law gap in the setting of Indonesia. The objectives of this study are:

1. To explore the nexus between legal liability and corporate fraud in Indonesia
2. To determine the role of business law and criminology in addressing corporate fraud in Indonesia

The study of how legal responsibility and corporate fraud relate in Indonesia is crucial for enhancing corporate governance practices. This study can offer useful insights to lawmakers, regulators, and companies in order to better improve their corporate governance processes and reduce the likelihood of fraudulent conduct by recognizing gaps and points of convergence within business law and criminology.

## 2. Methodology

Any study's research methodology is an essential component. Addressing the study's proposed goal is crucial. A more thorough comprehension, the bridging of disciplinary gaps, the integration of data, the enhancement of reliability and accuracy, and the generation of practical consequences can all be attained by using the interpretivism philosophy in this research of the nexus between legal liability and corporate fraud in Indonesia. It allows the researcher to explore numerous aspects of the phenomena, revealing broad reasons, activities, and patterns linked to corporate fraud in Indonesia. Therefore, interpretivism, which uses an inductive technique, is the most appropriate research study for the present study since it focuses on the relationship between legal liability and corporate fraud in the setting of Indonesia. It is legal research that includes the researching, tracing, and studying of secondary data associated with research material, laws and legislations, and associated policies. To identify legal concepts, legal doctrines, and legal laws to address various legal challenges, legal research is used. A "normative juridical research method" was used for this. Data for this study was gathered from a variety of primary legal sources, including various rules, laws, and other legal publications. Further secondary sources used in this study were reference books and online websites (Wiley Online, JSTOR, Taylor & Francis, West Law and other related sources) to collect the required data. The researcher also employed the conceptual and statutory approaches in the current study.

## 3. Literature Review

### 3.1 Nexus between legal liability and corporate fraud

Corporate liability needs to be enhanced in the current environment. The 20th century saw the primary emergence of the phenomena of corporate criminality. The objectives of criminal law and the financial inefficiencies driven by ineffective corporate law are tried to be balanced. An increase in white-collar crimes indicates a visible collapse in corporate governance, requiring stronger legal restrictions. The right standard has been proposed as the successful implementation of moral standards within the business framework using a combination of internal governance mechanisms and legal action (Kally, 2020). Corporate fraud has a number of negative economic effects on businesses, including harm to their brand, a decline in confidence among shareholders, higher financing expenses, and decreases in corporate value. It is important to experimentally investigate if the presence of numerous large owners

affects the degree of corporate fraud (Zhao et al., 2021). Their monitoring impact may lessen the amount of internal fraud that takes place in an organization. However, a firm may also be tunneled by a few major investors, which would undermine corporate governance and encourage corporate fraud. Corporate environments can exert pressure on ethically responsible people, leading to their behavior of making false financial statement disclosures (Rashid et al., 2022). Numerous businesses have failed as a result of accounting fraud, casting serious doubt on the accuracy of auditing. In these situations, the role of corporate governance, the integrity of executives and auditors, the influence of internal authority, the dependability of accounting records, and audit quality are all factors that should be taken into consideration (Mousavi et al., 2022).

The Indonesian government is working to maximize the business potential of its citizens by reducing conditions for those striving in the MSE sector due to the Job Creation Law as the nation's commercial sector continues to flourish. Single Business Organs' liability in Indonesia is confined; it cannot go beyond the company's capital. The shareholder, nevertheless, might be held personally liable in some situations (Tejomurti et al., 2022).

### *3.2 Business law and Criminology*

Crime issues, which make up the majority of criminological research, cannot be universally applied to all communities. Every society will have its own issues with crime, which may be successfully managed through local expertise. The positivistic strategy for crime control is not the only aspect of Indonesian conceptual theory that has been greatly influenced by Western ideas. In this regard, the majority of crime control measures were created with the presumption that Indonesian society is homogeneous, leading to the belief that a general crime control measure may be used everywhere (Mustofa, 2018). A considerable understanding of the criminal court system has been gained through analyzing criminal behavior economically. Both developed, and emerging regions are impacted by crime. Countries have been compelled to spend more on public safety and stability due to an increase in crime, which has resulted in inefficient use of assets in both the private and public sectors. Only a small number of previous research studies, meanwhile, have examined the relationship between crime rates and wealth disparity in Indonesia (Widyastaman & Hartono, 2022). From a criminological and lawful standpoint, Indonesia's cultural structure of misuse of power affects criminal conduct in ways other than just how public officials use their positions of authority and behave morally. In reality, numerous elected officials misuse their positions of authority by engaging in corruption or by receiving harsh penalties from the law. However, even those who commit power abuses persist in engaging in corruption, as seen by the lack of obvious consequences for those who do so (Riyadi, 2020).

The laws and guidelines that apply to all businesses are referred to as business law. It includes all of the legal provisions that are directly or indirectly related to operations, firm establishment, operations, logistical planning, agreements, and various international business activities. Business law is essential since it protects the customers as well as the company from every sort of corruption in the company. Laws are necessary for businesses operating in any market since they serve as regulations

that make it easier to conduct profitable companies (Alawaqleh, 2021). Business law, on the other hand, enables organizations to govern their operations in accordance with expectations and makes it easier for them to contact the government when there is a violation of the law (Mathafena & Msimango-Galawe, 2023). The business managers who defined businesses as individuals in their codes of behavior, sociologists, and ordinary individuals who make organizations communicate, believe, and act differently like real people were the inspiration for the criminologists who established the ideas of corporate crime and organizational crime (Cressey, 2017).

#### 4. Results and Discussion

This section mainly focuses on the results and discussion of the study. The present study focuses on the nexus between legal liability and corporate fraud in Indonesia. In order to achieve this aim, the legal liability of corporate fraud is determined in Indonesia, followed by business laws incorporating corporate fraud within the context of Indonesia.

##### 4.1 Legal Liability of Corporate Fraud in Indonesia

Corporate fraud is intentionally manipulating and deceiving financial transactions, statements and other information related to the corporate, which is conducted by the associated stakeholders for personal benefits. In Indonesia, corporate fraud is considered a serious offence that often leads to legal consequences for the associated organizations and individuals (Christian, Basri, & Arafah, 2019). In Indonesia, the legal liability of corporate fraud is governed by different regulations and laws, which are responsible for promoting accountability and transparency within the context of the corporate sector. However, corporate fraud is not regulated under the "Criminal law system" of Indonesia specifically. Article 378 of the "Indonesian Penal Code", which is also known as "*Kitab Undang-undang Hukum Pidana*" (KUHP), governs criminal fraud generally (Mustikasari & Muryanto, 2019). This article only focuses on the fraud committed by an individual, not a corporate. Therefore, a few other regulations by the "Indonesian Financial Services Authority," also known as "*Otoritas Jasa Keuangan*" (OJK), have also been expanded to corporate fraud (Wiradinata, 2014). Following laws and regulations are implemented in Indonesia to impose penalties or sanctions on different business entities or individuals:

- "Law No 38 of 2004 on Roads" (Article 65)
- "Law No 7 of 2014 on Trading" (Articles 115 and 107)
- "Law No 8 of 1999 on Consumer Protection" (Article 61)
- "Law No 32 of 2009 on Environmental Protection and Management" (Article 116) (Rahmadia, Disemadi, & Jaya, 2020)

Moreover, "Regulation No 13 of 2016" of the Supreme Court (PERMA 13/2016) is also effective in providing important guidelines regarding corporate crimes (Rahmadia et al., 2020). Corporate fraud also results in civil liability in Indonesia. Therefore, the shareholders, business partners and investors impacted by the corporate fraud can take legal actions to obtain compensation for their losses. They can file a civil lawsuit against the associated business entity or individual, charging them with fraudulent activities.

However, Indonesia has struggled to develop effective regulations within the context of corporate criminal liability, focusing on banking, tax, or economic fraud. Within the context of "Law No. 20 Year 2001", which is also known as "the Anti-Corruption Law," important amendments were made to eradicate corruption which was initially promoted by "the Law No. 31 Year 1999 regarding the Eradication of the Criminal Act of Corruption." Under this law, the directors or the company can be held responsible for corruption charges (Zulyadi, 2020). The Anti-Corruption Law's articles 3, 5 and 2 describe the preparatory of a corruption act as "*setiap orang*", which is stated as "*any person*." The definition of orang is presented under Article 1 of this law which also incorporates a company (Ningsih, Supanto, & Latifah, 2018). In this regard, a company is defined as a group of assets or individuals organized as a non-legal or legal entity. Therefore, it has been observed that criminal sanctions are imposed on any individual (incorporating a company) responsible for committing corruption under the Corruption Law provisions. However, a company's liability within the context of criminal acts has been promoted under Article 20 of "Anti-corruption Law." According to this article, if a company is held accountable for an act of corruption, the verdict and criminal charges will be imposed against the associated business entity or its officers. Even though clear language has been utilized in "Anti-corruption Law," still the Indonesian courts utilized this law in a limited number of cases concerning the corporate criminal liability of corruption. In Indonesia, the "Anti-Money Laundering (AML) Law" has also presented about 26 criminal actions in Article 2. In contrast, articles 3, 4 and 5 of this law focus on individual crimes and articles 6 and 7 deal with money laundering crimes conducted by corporations (Wulandari & Dermawan, 2022). Under these articles, different penalties are also imposed on the associated individuals or companies who are indulged in money laundering crimes. For instance, under Article 7 of this law, a fine of IDR100 billion (Saputra, 2021), is imposed on the corporations or individuals who are involved in money laundering.

#### 4.2 Business Laws Regarding Corporate Fraud in Indonesia

With the persistent increase in corporate fraud in Indonesia, different laws and regulations have been developed and implemented to ensure the safety of the associated stakeholders and shareholders. Even though corporate fraud has not specifically discussed under the KUHP, it still incorporates provisions regarding different types of corporate fraud, including forgery, financial fraud and others. This Code is also effective in providing different penalties for the associated criminal offences involving individual fraudulent activities. Other laws have also been developed and enacted in Indonesia to ensure the safety of a company's associated stakeholders and shareholders. For instance, Law No. 8/1995 (Capital Market Law) incorporates the regulations regarding capital market activities, focusing on disclosure requirements, trading security and preventing fraud in the capital market (Subroto, 2021). This law has also been effective in developing OJK, the integral regulatory body responsible for overseeing the activities of the capital market.

Additionally, Law No. 20/2008 ("Micro, Small, and Medium Enterprises Law" or MSMEs) focuses on protecting the MSMEs against unfair business activities and fraud. This law has also effectively promoted fair competition and protected the MSMEs' rights within the context of business transactions (Widiarty, 2023). Moreover, Law

No. 40/2007 ("Limited Liability Companies" (LLC) Law) governs the operation, development and dissolution of the LLCs in Indonesia (Wibisana, 2022). It incorporates important provisions regarding financial reporting, directors' responsibilities and corporate governance within the context of illegal and fraudulent activities. All these laws are considered effective in combating fraud. Still, none of these laws has specifically focused on the corporate fraud, which has limited the effectiveness of these laws within the context of corporate fraud in Indonesia.

Moreover, Law No. 31/1999 ("Corruption Eradication Law") mainly focuses on reducing corruption in Indonesia. The regulations of this law have also been expanded to the corporate sector in Indonesia (Najih & Wiryani, 2020). This law is also responsible for the development of the "Corruption Eradication Commission," also known as "*Komisi Pemberantasan Korupsi*" (KPK), which is stated as an independent agency accountable for the investigation and prosecution of different corruption cases within the context of both individual and corporate fraud. However, "Government Regulation No. 27/2014 on Financial Services Authority" also effectively empowers OJK to regulate and observe different financial services institutions such as insurance companies, banks and other associated sectors (Ardini, Maryam, & Munaa, 2020). Therefore, OJK is considered to play an important role in detecting and combating fraudulent activities within the context of the financial sector.

Therefore, in Indonesia, different laws and regulations have been developed to protect the rights and safety of the stakeholders and shareholders of the companies; however, no specific discussion of corporate fraud has been observed under the KUHP, which largely impacts the legal framework of corporate fraud in Indonesia. However, considering the significance of developing and implementing laws and regulations regarding corporate fraud, certain regulations regarding fraudulent activities were expanded to the corporate sector by the OJK. Therefore, there is still an urgent need to develop an effective and string legal framework for corporate fraud in Indonesia to overcome the associated challenges often faced by different companies, their shareholders and investors, which lead to negative financial and social outcomes.

## 5. Conclusion

The number of fraudulent cases is rapidly increasing, especially in the corporate world, leading to major concerns for stakeholders and investors. A large number of deceiving financial transactions have been observed in the past two decades, especially in the banking sector and other non-financial sectors, which has encouraged many companies to take important measures to prevent corporate fraud from developing and promoting a safe and effective corporate environment for the stakeholders and other associated investors. Therefore, the corporate world in Indonesia is also not safe from corporate fraud, and many corporate fraud cases have also been recorded in Indonesia. However, different laws and regulations have been developed worldwide to combat corporate fraud. In contrast, the legal framework regarding corporate fraud is not quite strong and effective in Indonesia. This study has also focused on the legal liability of corporate fraud in Indonesia. This research shows that the KUHP does not focus on the specific concept of corporate fraud, even though it has various laws and regulations regarding individual fraud.



Moreover, corporate criminal liability in Indonesia mainly focuses on AML Law and Anti-Corruption Law. However, the "Corruption Eradication Law" has also been effective. Additionally, the regulations of OJK and KPK are expanded to corporate fraud. Therefore, the legal framework of corporate fraud is not well-developed in Indonesia, creating a void in the associated legal framework. Thus, there is an urgent need to promote the concept of corporate fraud in the legal system of Indonesia to overcome associated issues. This study has effectively highlighted different practical implications of an effective legal framework concerning corporate fraud.

## 6. Recommendations

Corporate fraud has raised concerns for many shareholders and investors, preventing them from investing in different companies. This can largely impact the overall economic performance of the associated country. Therefore, to improve the overall legal framework of corporate fraud in Indonesia, the government and other associated organizations and stakeholders can take different important measures. A few of these recommendations are presented below:

- Companies should focus on developing and implementing essential corporate social responsibility (CSR) policies which will effectively promote the companies' transparency and credibility. This will be effective in preventing any fraudulent activities. Moreover, this approach will also effectively build strong relationships between the company and the associated shareholders/ investors, leading to effective financial outcomes.
- Important amendments should be made in the KUHP to promote the concept of corporate fraud to obtain national recognition. Even though individual fraudulent activities are highlighted in the KUHP, it lacks the incorporation of important regulations and laws regarding corporate fraud. This approach will also be effective in encouraging the government of Indonesia to develop a separate comprehensive law focusing on corporate fraud. This will encourage the Supreme Court to utilize this law in different cases.
- The incorporation of corporate fraud in business laws should also be encouraged. This will help develop and implement important policies and regulations in different businesses to combat fraudulent activities. In this regard, collaboration between private and public organizations will be crucial to achieving effective outcomes. Moreover, promoting such regulations and policies will also improve public knowledge regarding corporate fraud, encouraging them to play their role in preventing such issues.

## 7. Research Implications

### 7.1 Theoretical Implications

The present study has effectively fulfilled its aim, which mainly focuses on determining the legal framework of corporate fraud in Indonesia. Therefore, along with its theoretical significance, the present study is also effective practically. This study has effectively improved the literature regarding the legal liability of corporate fraud in Indonesia. After an excessive literature review, it was observed that most research studies focused on the legal framework of corporate fraud within Indonesia, creating a void in the past research; thus present study will effectively fill this gap.

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Moreover, this study has also presented an effective conceptual framework regarding the association between business laws and corporate fraud in Indonesia, which will effectively encourage future studies to focus on the limitations within the context of business laws regarding corporate fraud in Indonesia. The results obtained from this study are also effective in presenting the role of OJK in regulating corporate fraud in Indonesia. This approach also added novelty to the current study, leading to effective outcomes. Additionally, the limitations regarding corporate fraud within the context of KUHP can also be observed in this study, which can be helpful for future researchers to develop effective research strategies in determining the specific association between corporate fraud and business laws and regulations of Indonesia.

### 7.2 Practical Implications

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Apart from its theoretical implications, the present study is also effective in promoting different practical implications, which can effectively improve the current study's overall performance. This study has effectively highlighted the limitations of KUHP regarding corporate fraud; therefore, this can encourage the government of Indonesia and other associated organizations to formulate and implement important laws and regulations to combat corporate fraud. This study can also be effective in highlighting the role of different agencies such as KPK and OJK in investigating corporate fraud, which can help in motivating these agencies to develop and implement important regulations to protect the companies and associated stakeholders against different corporate frauds such as money laundering, corruption and others. This can encourage the government to develop an effective legal framework focusing on corporate fraud. This will help combat corporate fraud in Indonesia, leading to effective outcomes. Moreover, this study can also effectively encourage different policymakers to develop and implement important policies which focus on promoting anti-corruption activities. However, this research can also be used as a source of information which can be used to improve public awareness regarding corporate fraud and legal obligations on companies to combat corporate fraud and other associated criminal activities.

### 8. Limitations and Future Research

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Almost every research study has its effectiveness and limitations. Similarly, the current research also incorporates some limitations which are difficult to avoid. Therefore, this section highlights different limitations of this study which are considered effective in paving the way for future research within the context of legal liability of corporate fraud. First, it has been observed that the current study only focused on corporate fraud within the context of Indonesia due to researcher bias. Not much focus has been given to individual fraud, which limits the effectiveness of this study. Second, the present study only focused on the legal liability of corporate fraud in Indonesia, a civil country; no focus has been given on corporate fraud within the context of a common country. The easy accessibility of required data within Indonesia largely influenced this approach. Third, this study utilized a qualitative approach to analyze the nexus between corporate fraud and legal liability in Indonesia due to time constraints. No quantitative or primary data has been focused on in this regard, which largely impacted the performance of this study.

Therefore, future research can overcome these limitations by taking important measures. For instance, in future research, a comparative analysis can be conducted to determine the legal liability of corporate fraud within the context of both common law and civil law countries. Additionally, in future studies, primary quantitative data can be collected to determine the prevalence of corporate fraud in Indonesia. This will help in achieving effective outcomes. Moreover, in future studies, both individual and corporate fraud can be highlighted to better understand the role of different organizations in combating these fraudulent activities.

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