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FACTORS STIMULATING CORPORATE CRIME IN MALAYSIA

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ABSTRACT

Building on the perception of both existing and potential investors in Kuching, Sarawak, this study aims to identify the factors that appear to stimulate corporate crime activity in organizations. A survey was carried out by distributing questionnaires to both types of investors selected on randomly basis. The findings reveal that corporate crime activities are mostly due to inadequate cash security practices, inadequate supervision as well as a lack of internal auditing. To minimize the effects of corporate crime on investors and organizations, managers should pay extra attention to these factors. On the other hand, future research within the context of corporate crime may consider the extent to which organizational crime can affect the shareholder value creation of organizations.

Keywords: Corporate Crime, Internal Control

JEL Classification: K42, K20

INTRODUCTION

Fraud is a significant and growing threat worldwide. Over recent years, fraud has received tremendous attention among the public. Though fraud can be easily committed, but prevention or detection of corporate crime is not an easy task (Seetharaman *et al.*, 2004). At the same time, knowledge about the organizational conditions that can reduce the cost of white-collar crime is yet little is known (Schnatterly, 2003).

Corporate crime is not new in Malaysia and based on the cases reported each year, the rate is on the upward trends. According to KPMG Malaysia fraud survey (KPMG, 2005), it is found that there has been an increase of 33% of the respondents experiencing fraud in their organizations, as compared to the 2002 survey. In Malaysia, white-collar crime has caused losses of exceeding RM3.93 billion from the year 1999 until 2002, with approximately 6,000 cases being reported yearly (Clarence, 2005). Additionally, 36% of companies have suffered a total losses between RM10,001 to RM100,000 due to fraudulent conduct between January 2003 to December 2004, while 17% have suffered losses exceeding RM1 million (KPMG, 2005). On the other hand, assessing the company's risk to corporate crime is getting more

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complicated particularly when the transactions are performed electronically and operations are being done geographically separated from each other (Seetharaman *et al.*, 2004). Therefore, it is anticipated that corporate crime will continue to become a serious corporate problem and the loss wrecked by economic crime goes exceedingly direct monetary loss.

Building on the perception of both existing and potential investors, this study aims to identify the factors that may foster corporate crime activity in organizations. We carried out our survey by distributing questionnaires to both types of investors selected randomly. The findings reveal that corporate crime activities are mostly due to inadequate cash security practices, inadequate supervision as well as a lack of internal auditing. We suggest that in order to minimize the effects of corporate crime on investors and organizations, managers should pay extra attention to these factors and proactively as well as effectively manage their resources. Finally, we recommend for future research to examine the extent to which corporate crime can affect the shareholder value creation of organizations.

LITERATURE REVIEW

In the early years, corporate illegalities were regarded as corporate crimes activities. Fraud is considered as in the making if one tries to deliberately plan, deceit or con with the intention of deprive other's property or rights, regardless of whether the perpetrator gains any benefit or not in the process (KPMG, 2005). Illegal activities are often committed by members or agents of a firm (Baucus and Baucus, 1997). Notably, as pointed out by Szwajkowski (1985), corporate crime is an unlawful activity pursued by employees for their own benefit.

In terms of nature and type of corporate crime usually committed, KPMG Malaysia fraud survey (KPMG, 2001) reveals that the highest losses involved secret commission (43%), followed by expense account (29%), false invoicing (27%), and others which include purchases for personal use, cheque forgery, price fixing, corporate surveillance and automatic teller machine fraud. Although corporate crime has been associated with members of top management team, however, the report shows that 74% of the respondents claimed that frauds were committed by non-management category. Later, a separate study was conducted by PricewaterhouseCoopers (2005) and the results seem to be consistent with that of KPMG (2001). Both surveys disclose that most of the fraud incidents are committed by the employees of the convicted organizations. It is argued that employees tend to have a better

understanding of the operation of the business. In short, the main culprits who commit crime in organizations are non-management employees.

Why employees commit corporate crime? [Goldstraw et al. \(2005\)](#) posit that greed, gambling, financial strain either personal or business, feasibility of business, and influence of others are the major factors stimulating illegal behavior among employees. In fact, gambling related activity is one of the main factors that trigger corporate crime activity in Australia ([Blaszczynski and McConaghy, 1994](#); [Crofts, 2002](#)).

In addition, other factors which contribute to corporate crime activities include situational pressures, opportunities to commit fraud and personal characteristics ([Albrecht and Romney, 1980](#); [Romney et al., 1980](#)). A more recent survey published by [PricewaterhouseCoopers \(2005\)](#) also reveals that the perpetrator's need to maintain an expensive lifestyle (39%), lack of internal controls in the company (41%) and the perpetrator's low temptation threshold (50%) or lack of awareness that what he or she was doing was wrong (52%) are clear cut evidences that contribute to corporate crime as well. Furthermore, the survey also indicates that since 2003, a high number of economic crimes also committed by big well-established companies due to certain reasons such as greater opportunities or tendency for fraud to happen in large companies, transactional complexity, better fraud detection systems, and threats arising from international operations. Based on the analysis done by [KPMG \(2001\)](#), the main reasons for fraud to happen in Malaysia are due to poor management or internal controls (35%), conspiracy between employee and third party (27%), and type of business operation that is favorable for fraud to happen (21%).

The consequences of corporate crime are very serious. According to [Agro \(1978\)](#), fraud was a major factor that contributed to the shutting down of about 100 banks during a 20-year period in the United States. The finding in an economic survey by [PricewaterhouseCoopers \(2005\)](#) announces that fraud causes major damages or setbacks to the organization. The setbacks include decline of staff morale (54%), loss of reputation (43%) and impairment of business relationships (42%). However, not all of the corporate crime activities have been reported. The study by KPMG Malaysia fraud survey ([KPMG, 2005](#)) highlights that the main reason why firm not reporting fraud was fear of negative publicity (28%) followed by no chance of financial recovery (20%).

To cope with ever increased of corporate crime activities, organizations have tried several ways to uncover illegal behavior among the employees. The survey made by [KPMG \(2001\)](#) reveals that majority of the fraud incidents was discovered through management investigation (30%), internal controls (27%), employee notification (23%) and internal auditor review (21%). On the other hand, [Seetharaman et al. \(2004\)](#) propose that the most effective detection methods are internal audit review, specific investigation by management, employee notification and accidental discovery. In addition, fraud cases can be lessen with effective monitoring skills and controls, huge awareness of prevention and anticipation, and effective action when fraud happens ([PricewaterhouseCoopers, 2005](#)). Nevertheless, [Jerry et al. \(2003\)](#) have pointed out that the ability of an auditor to accurately trace the risk of fraud is important. Most importantly, companies need to seriously review the risks of fraud within the organization, firmly declaring the company's stance to fight fraud and implementing it, strict and tight monitor on risky areas, encourage and protect people who are bold to report on fraud and have a good fraud counteract plan ([PricewaterhouseCoopers, 2003](#)).

Corporate crime is something that should be taken seriously in order to avoid direct financial losses, prevent jeopardize of reputation and damage relationship with stakeholders such as customers, suppliers, financiers and other business partners. Past studies regarding corporate crime were largely conducted in developed countries like the United States, Australia, and New Zealand. Therefore, there is a lack of empirical evidence concerning corporate crime in developing country such as Malaysia. This study intends to fill the existing gap in the literature and consequently enable managers to take preemptive actions to handle this issue when it arises.

DATA AND METHODOLOGY

The aim of this study is to investigate the factors that can cause corporate crime in organizations. Instead of drawing our sampling population from the employees of organizations, the respondents were selected randomly from the existing and potential investors. They were asked to indicate their perception about factors that can spur corporate crime activity in organizations. This is because investors will normally react to any news concerning illegal activities occurred in organizations ([Rao, 1996; Rao, 1997; Voon et al., 2008](#)).

To capture the factors that contribute to corporate crime activity, specific variables used and published by the [Australian Institute of Criminology and PricewaterhouseCoopers \(2003\)](#) were adopted. The questionnaire is divided into two major sections. The first part is regarding the demographic of the respondents, including gender, age, race, marital status, education level, occupation and monthly income level. The second part of the questionnaire solicits the respondents' view about the factors stimulating corporate crime. These factors are further divided into five main categories namely prudential failures, personnel failures, accounting/auditing failures, security failures, and regulatory failures. Here, the respondents were required to indicate their perception on the degree of agreeable on a five-point Likert-scale, denoted by "1" strongly disagree, "2" disagree, "3" neutral, "4" agree, and "5" strongly agree. The results of the survey were entered and analyzed using the Statistical Package for Social Sciences (SPSS). A total of 285 questionnaires were distributed randomly to the respondents, however, only 200 usable questionnaires were collected, representing a 70.18% response rate. The following section highlights and discusses the findings obtained from this survey.

RESULTS AND DISCUSSION

Demographic Information of Respondents

The respondents comprise of 93 male and 107 female. Majority of the respondents falls between 20 to 29 years old. Only 61 of them are in between the ages of 30-39. A very small number of respondents were below the age group of 20. There are a total of 108 Chinese respondents, followed by 51 Malay respondents, 36 respondents from ethnic group (Iban and Bidayuh), and 5 Indian respondents. On the marital status, 104 respondents are single, while 96 respondents are married. In terms of education level, majority of the respondents are degree holders (114 persons), and this is followed by 32 respondents with diploma. There is a minority group of 6 respondents who hold the certificate qualification. Meanwhile, 90 respondents performed professional duties and another 60 of them work as administration and management staffs. The minority groups are unemployed (2 respondents) and self-employed (1 respondent). Lastly, in terms of monthly income, most of the respondents (103 persons) are earning between RM2,000 to RM3,999 per month. Table 1 below depicts the demographic of the respondents.

Table 1: The Respondents' Demographic Information

No.	Demographic Information	Quantity	Percentage (%)	
1	Gender	Male	93	46.5
		Female	107	53.5
2	Age	< 20 years	3	1.5
		20-29 years	102	51.0
		30-39 years	61	30.5
		40-49 years	24	12.0
		> 50 years	10	5.0
3	Race	Malay	51	25.5
		Chinese	108	54.0
		Indian	5	2.5
		Others	36	18.0
4	Marital Status	Single	104	52.0
		Married	96	48.0
5	Education Level	SPM and Below	19	9.5
		Certificate	6	3.0
		Diploma	32	16.0
		Degree	114	57.0
		Professional Course	10	5.0
		Master and Above	19	9.5
6	Occupation	Professional	90	45.0
		Administration and Management	60	30.0
		Clerical	16	8.0
		Sales and Services	14	7.0
		Technical	17	8.5
		Self-employed	1	0.5
		Unemployed	2	1.0
7	Monthly Income Level	Below RM2,000	76	38.0
		RM2,000-RM3,999	103	51.5
		RM4,000-RM5,999	15	7.5
		RM6,000-RM7,999	4	2.0
		RM8,000 and Above	2	1.0

Relationship between Demographics and Importance Level

One-way analysis of variance (ANOVA) was conducted to determine whether respondents' perceptions of the factors stimulating corporate crime were influenced by respondents' demographic characteristics. The results of the analysis are presented in Appendix 1. It was discovered that all the demographic characteristics do not appear to have a significant effect on respondents' perception towards factors stimulating corporate crime.

Result and Data Analysis for Factors Stimulating Corporate Crime

Table 2 shows the ranking of factors stimulating corporate crime by the respondents. All the 25 factors show an average score of above 3.0000, with the highest score is 3.9500, indicating that most of the respondents are agreed with the factors listed in the questionnaire.

Table 2: Ranking of Factors Stimulating Corporate Crime

Rank	Factors Stimulating Corporate Crime	Mean
1	Inadequate cash security practices	3.9500
2	Inadequate supervision of staff	3.9050
3	Internal auditing failures	3.8800
4	Failure to verify identification evidence	3.8500
5	Inadequate purchasing/procurement controls	3.8450
6	Inadequate staff employment screening	3.8300
7	Poor cheque control procedures	3.8250
8	Failure to analyze loss or profit	3.8050
9	Inadequate card security controls	3.7950
10	Inadequate computer access controls	3.7950
11	Failure to segregate staff duties	3.7850
12	Failure to secure personal identification	3.7800
13	Poor investment controls	3.7800
14	Professional regulatory failures	3.7700
15	Unusual patterns in financial transactions	3.7550
16	Use of unusual payment methods	3.7500
17	External auditing failures	3.7500
18	Failure to comply with legislative requirements	3.7300
19	Failure to verify ownership of property	3.7100
20	Living beyond one's means	3.6900
21	Failure to verify credit-worthiness of applicants for credit	3.6100
22	Failure to monitor offender on bail/in custody	3.5700
23	Staffing changes/new auditors	3.5400
24	Failure to verify insurance claim	3.4250
25	Staff not taking leave/working after hours	3.3300

Inadequate cash security practices have been perceived to be the most acceptable factors that have contributed to corporate crime activity (mean = 3.9500). These are followed by inadequate supervision of staff (mean = 3.9050), internal auditing failures (mean = 3.8800), failure to verify identification evidence (mean = 3.8500), and inadequate purchasing/procurement controls (mean = 3.8450). Table 3 in the following discussion reflects the perception of investors regarding corporate crime activities from different dimensions.

The findings from this study show that any failures in certain group or any inadequate control in the organization can be a major factor stimulating a person to commit in corporate crime, as this will provide the person an opportunity to do so. Staff not taking leaves or working after hours (mean = 3.3300) is perceived as the least acceptable factor that stimulates corporate crime. This may be due to the working culture in certain company that requires the staff to work after office hours or leave are not approved in order to complete certain urgent task.

The grouping of the factors stimulating corporate crime is further illustrated in Table 3. From the analysis, security failures (mean = 3.8300) are perceived to be the most acceptable factors comparing with the other four groups of factors. This is followed by accounting/auditing failures (mean = 3.7880), regulatory failures (mean = 3.7500), prudential failures (mean = 3.7207) and personnel failures (mean = 3.6643).

Table 3: Factors Stimulating Corporate Crime by Group

Factors Stimulating Corporate Crime	Individual Mean	Group Mean
<i>Prudential Failures</i>		3.7207
Poor investment controls	3.7800	
Poor cheque control procedures	3.8250	
Failure to verify identification evidence	3.8500	
Failure to verify ownership of property	3.7100	
Failure to verify credit-worthiness of applicants for credit	3.6100	
Failure to verify insurance claim	3.4250	
Inadequate purchasing/procurement controls	3.8450	
<i>Personnel Failures</i>		3.6643
Inadequate staff employment screening	3.8300	
Inadequate supervision of staff	3.9050	
Failure to segregate staff duties	3.7850	
Staffing changes/new auditors	3.5400	
Living beyond one's means	3.6900	
Staff not taking leave/working after hours	3.3300	
<i>Accounting/Auditing Failures</i>		3.7880
Internal auditing failures	3.8800	
External auditing failures	3.7500	
Unusual patterns in financial transactions	3.7550	
Failure to analyze loss or profit	3.8050	
Use of unusual payment methods	3.7500	
<i>Security Failures</i>		3.8300
Inadequate computer access controls	3.7950	
Inadequate card security controls	3.7950	
Inadequate cash security practices	3.9500	
Failure to secure personal identification documents	3.7800	
<i>Regulatory Failures</i>		3.7500
Professional regulatory failures	3.7300	
Failure to comply with legislative requirements	3.7700	

In comparison, the findings in [Australian Institute of Criminology and PricewaterhouseCoopers \(2003\)](#) indicate that prudential failures comprise of 95 cases of corporate crime, but in terms of personnel failures only 53 cases, 36 cases in terms of accounting/auditing failures, security failures account got 21 cases, and lastly regulatory failures result only 9 cases respectively. The results obtained from this study seem to be

different from the findings in [Australian Institute of Criminology and PricewaterhouseCoopers \(2003\)](#). This can be explained as different countries have different patterns of factors stimulating corporate crime. Above all, the respondents perceived that security failures would create an opportunity to a person to have a chance to commit in corporate crime. Besides, accounting/auditing failures will cause corporate crime unable to be discovered.

Table 4 reveals the statistically significance between group differences for the factors stimulating corporate crime. From the results of the *T*-test, statistically significance between groups differences only involve those associated between prudential failures and accounting/auditing failures ($p < 0.10$), prudential failures and security failures ($p < 0.05$), personnel failures and accounting/auditing failures ($p < 0.01$), personnel failures and security failures ($p < 0.01$), and security failures and regulatory failures ($p < 0.10$).

Table 4: T-test Results

Factors Stimulating Corporate Crime Group	T-value	Significance Level
Prudential Failures vs Personnel Failures	1.473	0.142
Prudential Failures vs Accounting/Auditing Failures	-1.875	0.062*
Prudential Failures vs Security Failures	-2.574	0.011**
Prudential Failures vs Regulatory Failures	-0.593	0.554
Personnel Failures vs Accounting/Auditing Failures	-2.870	0.005**
Personnel Failures vs Security Failures	-3.706	0.000**
Personnel Failures vs Regulatory Failures	-1.628	0.105
Accounting/Auditing Failures vs Security Failures	-1.046	0.297
Accounting/Auditing Failures vs Regulatory Failures	0.761	0.448
Security Failures vs Regulatory Failures	1.734	0.084*

Note: Asterisks (***), (**) and (*) denote significant at 1%, 5% and 10% levels, respectively.

CONCLUSION

Issue regarding corporate crime activity continues to receive considerably attention among the public, especially investors, investment managers and also regulators. Corporate crime is a serious crime that relates to the ethical behavior, which should not be taken lightly. Corporate crime not only has deep impact on the reputation of the company affected, but also causes great financial loss and loss of investors' confidence. This study gathered 200 useful questionnaires from potential and existing investors in Kuching City. The questionnaire was carried out to capture respondent's perception on factors stimulating corporate crime. The study suggests that inadequate cash security practices appear to be top factor stimulating

corporate illegality. This is because cash is very liquid and easier to be misused. In addition, inadequate supervision of staff scored the second highest as factor that result in corporate crime. The third highest ranking factor is internal auditing failures. Without an efficient internal auditing, any misappropriation of company's proceeds or assets as well as other resources cannot be detected easily, and thus promotes corporate crime. Hence, the findings of this study once again reinforce previous studies on corporate crime.

It is recommended that in order to minimize corporate crime activity, implementing good and effective corporate governance structure and other auditing mechanisms would be necessary and beneficial. Preemptive action should be taken before corporate crime can occur. In addition, in order to battle corporate crime, management, employee, public as well as the regulators have to co-operate. The results of this study should serve as a warning to organizations that crime can occur if the organizations fail to take extra efforts from time to time. Secondly, these findings may motivate future research to develop effective corporate crime detection methods not only in Malaysia but also in other countries. Finally, future research should also consider the extent to which corporate crime activity within organizations can affect the shareholder value creation of the affected organizations.

In terms of limitation, we admit that the questionnaires should be distributed to a bigger group of respondents so that the results can be generalized. Moreover, the respondents were asked to indicate their perception on a five-point Likert-scale. Using five-point Likert-scale will lead to the use of "3" which represents neutral response. It is argued that the inclusion of neutral response might not enhance the quality and accuracy of the findings (Krosnick *et al.*, 2002). Therefore, future research should consider questionnaire with four-point Likert-scale as suggested by Krosnick *et al.* (2002).

Appendix 1: Analysis of Variance (ANOVA) of the Respondents' Demographic Characteristics towards Respondents' Perception of the Corporate Crime Discovery, Corporate Crime Determinants and Factors Stimulating Corporate Crime

Demographic	Corporate Crime Discovery		Corporate Crime Determinants		Factors Stimulating Corporate Crime	
	F	Sig.	F	Sig.	F	Sig.
Gender	0.855	0.700	1.592	0.020*	0.975	0.529
Age	0.865	0.686	1.201	0.206	1.326	0.100
Race	1.273	0.160	0.923	0.613	0.944	0.583
Marital Status	1.037	0.423	0.985	0.507	1.156	0.251
Education Level	0.720	0.873	1.468	0.045*	0.815	0.797
Occupation	0.352	1.000	1.358	0.088	1.132	0.282
Monthly Income	0.585	0.968	1.033	0.429	1.198	0.203

Note: Asterisk (*) denotes significant at 10% level.

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