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ENTREVISTAS Y DEBATES

CORPORATE GOVERNANCE LESSONS FROM ORGANIZED CRIME

EDITOR'S NOTE*

On December 5, 2024, during the International Closing Conference of the 20th Regional Symposium on Accounting Research—organized by the Institute for Accounting Research and Studies (IIEC) of the Faculty of Economic Sciences at the National University of La Plata (UNLP)—Professor Jerold L. Zimmerman, Bittner Emeritus Professor at the University of Rochester Simon Business School (USA), presented the lecture titled “Corporate Governance Lessons from Organized Crime” (Investigación FCE UNLP, 2024), drawing on the concepts developed in his book *Relentless - The Forensics of Mobsters' Business Practices*. The event was followed by an exchange with the audience, moderated by Dr. Mariano Scapin, Senior Lecturer in Accounting, University of Bristol (UK).

This publication is structured in two parts: the first presents the transcription of Professor Zimmerman's lecture; the second reproduces the transcript of the subsequent discussion with the audience, moderated by Dr. Scapin. Both sections have been reviewed and validated by their respective authors. The purpose of this publication is to disseminate, in academic format, the original conversation held during the public lecture, with the aim of making it accessible to a broader readership and contributing to the ongoing debate on the issues addressed. By offering a stable document, it ensures preservation, citability, and traceability as a primary source.

*Hugo Collacciani for the Editorial Board.

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FIRST PART

LECTURE BY JEROLD L. ZIMMERMAN

Hello, I'm Jerold Zimmerman. I want to thank the organizers for giving me this opportunity to discuss the forensics of mobsters' business practices. My talk is based on a book I published a few years ago called *Relentless - The Forensics of Mobsters' Business Practices*.

Let me give you a disclaimer before I get any further, and that is that the book and my talk is not intended to romanticize or legitimize organized crime. However despicable these criminals are, they were able to devise management processes that were able to channel mobster self-interest to supply illegal goods and services that generate profits while they're eluding enormous law enforcement resources and rival gangs.

The motivation for the book was that these organized crime syndicates continue to exist despite enormous obstacles. Some of them can survive for long periods of time.

THE CHALLENGES OF ORGANIZED CRIME

There are massive law enforcement resources focused on their demise. And what is interesting when you think about it is that these organized syndicates of criminals are not able to use our common institutions of free markets such as courts that enforce contracts and financial institutions that facilitate trade. They are basically running an all-cash business. How do they do this? How are they able to survive?

Well, organized crime develops corporate governance practices that attract, retain, and motivate their members to generate profits and to avoid extermination from law enforcement and rivals. Basically, the book is about the corporate governance mechanisms of these criminals. The book talks about and analyzes four different crime syndicates. The American Mafia, the Sinaloa Cartel, the Hells Angels, and the Bloods and Crips street gangs.

THE FOUR PILLARS OF CORPORATE GOVERNANCE

The paper has several key takeaways. One and the most important is that there are four essential management systems that I refer to as the four pillars and these complement each other, and they are at the foundation of the governance mechanisms of these crime syndicates. Changes in the organized crimes strategy and the four pillars then respond to environmental threats and opportunities. In other words, as the environment of the criminal syndicates change, we see that the four pillars respond to these changes as either threats or opportunities.

The four pillars—the fourth pillar, which is corporate culture, and we'll talk more about the four pillars—is really very important in these criminal organizations. The fourth pillar defines and communicates the unique and often immoral values held by members of organized crime. The culture attracts people with these values, and it rewards productive criminals with safety, a sense of belonging, camaraderie, and recognition. While lawful managers cannot mimic the organized crimes' four pillars, they must follow the same economic principles to devise optimal structures and managerial processes aligned with their unique strategies.

So, economists and accountants talk about the agency problem, and the key agency problem is how to attract, retain, and motivate self-interested workers to execute the firm's strategy. Both legal and illegal organizations face the same agency problem.

Basically, how do you get employees, how do you provide incentives for the employees that align with the firm's strategy? And the history of these organized crime syndicates illustrates how each one, which are very different from each other, do this.

1. Task assignments

So, what are these four pillars? I've already alluded to the culture pillar, but the first pillar is the task assignments pillar. The second is how you provide performance measures. How do you then construct rewards and punishments? And finally, is corporate culture, which I've mentioned. So let me just briefly define each of these. The task assignment pillar involves assigning tasks to people who have the necessary skills to execute the task. They have the information to make those decisions, the skills, and they have the incentives to execute the task in the firm's interest and not in their self-interest. The general question of should the firm be decentralized or centralized is part of the task assignment pillar.

2. Performance Measures

The second pillar is performance measures. That once you assign a task to an individual or to a team of individuals, then how do you measure their performance? In profitable legal firms, we often see profits or earnings being used or sales growth. Or customer/employee satisfaction. These are all commonly used performance measures in legal organizations. We see that in these various criminal syndicates, they also have their own unique performance measures.

3. Rewards and Punishments

The third pillar is once you measure performance, how do you then reward and punish people? Legal firms have bonuses, promotions, demotions, and terminations. In criminal organizations, their terminations are very different than in legal organizations.

4. Corporate Culture

The fourth pillar is corporate culture. And by corporate culture, what we mean are values and beliefs held by people in the organization. And the values and beliefs of people operating in legal organizations are very different than the values and beliefs of people in illegal syndicates. But all of these organizations, their corporate culture, there are various norms and behaviors that are communicated to the people in the organization, either through outside events or newsletters or emails from the CEO.

Strategic Adaptation to Dynamic Factors Strategic Adaptation to Dynamic Factors



[fig. 1]

So, the important findings, the one key is that these four pillars are dynamic and adaptive. And by that, I want to show you figure one, which in my view is a very powerful way to think about how organizations evolve over time. There's a series of external factors affecting the organization's strategy. For example, if the government comes along and changes tax laws, then the firm often will have to find a new strategy. Or if there are technological innovations like AI, we see AI as a major disruptor, and we're observing companies trying to adapt AI in forming a new business strategy or line of business or products.

And so, as these external factors start to affect the firm, the organization's strategy and brands are often then refined or changed. Once you change a strategy, then you have to go in and look at how your four pillars have to be adapted to implement the new strategy. And finally, the four pillars will affect how the firm operates, its profits, its growth, its decline. If the performance and survival prospects are not up to the company's liking, then there's a feedback loop that there is often a reevaluation of the strategy and the four pillars.

HISTORICAL EXAMPLES OF ORGANIZATIONAL ADAPTATION

And we see this acting out in these criminal organizations. One example, a classic example, is when the United States in the 1920s prohibited the sale and consumption of all alcoholic beverages throughout the United States. We saw small street gangs in cities, mainly Italian or Sicilian descendants who were already doing petty crimes and doing business as opening gambling parlors. Suddenly they had a new profit opportunity—the sale and distribution of illegal alcohol. And all of a sudden, we observe these crime families, what became crime families, just become supercharged because they were making so much money on illegal alcohol. So that is one example from the book. The book has numerous other examples.

The one I like is that when the United States in World War II started rationing things like sugar and meat and gasoline, these crime families, the mafia in particular, started counterfeiting the coupon—the rationing books that were used—or they just outright stole them from government warehouses. Again, that's an example of how external factors affected the business strategies and ultimately the four pillars of the mafia. The other key finding from these crime syndicates is that the four pillars are complements, that they complement each other.

PILLAR COMPLEMENTARITY AND LONGVIEW

Tasks are assigned to people with superior knowledge and incentives. And the mafia, for example, would specialize by types of crimes, stealing goods as they were coming into the ports off ships or off airplanes. They had access to the guards on the docks and they knew what was coming in. And this changed on a daily basis, and so local gangsters were assigned the tasks of stealing goods and services off the docks or out of the airports. Performance was very simple; it was based on how well the person with the task performs.

If they successfully stole goods that they were able to sell, they kept something like 85% of what they stole and they passed 15% of the stealings up the chain to their bosses.

So, we see that the rewards and punishments were tied directly to performance. And they had a culture that communicated these desired behaviors. If you watched any of the films of the United States—movies on the Mafia, you see they have these elaborate ceremonies where they initiate people into the families.

Most of these organized crime syndicates shun short-termism. They take the long view. Before you became an official member of a mafia family, you could often spend 10 to 20 years of being a non-family member criminal working for one of the family members. These long apprenticeships allowed the mob leadership to determine who was going to be a good family member, a loyal family member. They had these rules—the mafia in the United States had the rule that you don't kill law enforcement officials, you don't kill judges—mainly because it's bad for business. It's better to go away to jail for five or 10 years than to kill a judge because then that would really be a bad thing in the short run. They also rewarded very heavily loyalty and respect. You respected the bosses.

ACCOUNTING IMPLICATIONS

So, what were the accounting implications? The interesting thing is that all these organized crime syndicates, almost all of them avoided accounting records. You probably have heard of a famous Chicago mobster, Al Capone—he was actually arrested and went to jail for tax evasion because he kept detailed profit and loss records of his brothels and his gambling activities. And when the government seized these records, they showed the enormous profits that Capone and his gang were making. And they didn't send him to jail for prostitution or gambling, they sent him to jail for tax evasion. And based on that, most criminals have avoided writing anything down. So, most of the transactions in these organizations were by word of mouth. Somebody said that they would do something or that they made a certain amount of money on a particular heist, they would just take it on faith. That that's how much they made. Now, if the person shows up driving around in a new Mercedes a couple days later, and it's a very expensive Mercedes, then the bosses might think that he wasn't very honest in terms of telling you how much money he made in the theft. Most electronic communications—emails and texts—were avoided to reduce informing law enforcement. And so what is interesting about these criminal organizations is that accounting is not necessary for success because most criminal syndicates avoid accounting record keeping.

ORGANIZED CRIME THRIVES WORLD-WIDE

The interesting issue to me is that organized crime thrives worldwide. It certainly exists in the United States. The Hells Angels on their website say that they have 590 clubs operating in 66 countries. Now, not all Hells Angels clubs are organized as criminal organizations.

Several thousand mafia members continue to operate in the United States, mainly along the eastern seaboard, but they're in other cities as well. Their business models have changed. They are doing a lot of internet theft, and identity theft, and things like that.

And in fact, just last year six New York City mafia members pleaded guilty to racketeering, which is loan sharking and gambling too. So, even without accounting systems, the mafia survives, as does the Hells Angels.

CONCLUSIONS

So, in conclusion, like legal businesses, organized crime syndicates have to develop unique four pillars to attract and retain self-interested employees. They align the criminals' self-interest to the syndicate's strategy to solve the basic agency problem that they face.

And many crime syndicates deploy very decentralized structures. They're highly efficient operations. They have protection. They buy protection from law enforcement in many cases, by bribing local officials.

Another conclusion is that legal businesses cannot simply copy the four pillars of the crime syndicates. Both differ in very significant ways. Lawful firms and unlawful firms are very different. They differ in very significant ways.

The primary difference is the use of physical violence in one and not in the other. One has access to courts, the others don't. Each develops specific pillars for its unique situation. And lawful managers must design their own four pillars using the same well-accepted economic principles followed by crime syndicates.

So, with that, let me end my talk and take questions.

Thank you very much and I look forward to your questions.

SECOND PART

Q&A SESSION WITH JEROLD L. ZIMMERMAN, MODERATED BY MARIANO SCAPIN

— MARIANO SCAPIN

Thank you, Professor Zimmerman, for your presentation. I would like to follow up by asking you a couple of questions.

You discussed that successful crime organizations need to develop the four pillars for survival. However, do these crime organizations develop these four pillars for survival, or is this a basic thing that they need to do to start operating?

— JEROLD ZIMMERMAN

What you must recognize is that these are successful organizations or else we wouldn't know anything about them. The fact that they've survived in the United States going back to the 1920s says that they got this right.

Now, whether they got it right because they were smart or got all these pillars right because they were lucky, we really don't know. But we do know as new criminal opportunities arise such identity theft, they modified the four pillars to provide incentives that support the new criminal opportunities. Identity theft was not a problem 100 years ago because we didn't have all these electronic transactions that people can steal once they have your identity. And so, once you have these opportunities, then they would modify their four pillars.

We see legal firms doing the same thing. Following deregulation or re-regulation in an industry, you typically observe a lot of mergers and acquisitions as firms try to realign their business strategies. And once they do that, they must redesign their four pillars.

— MARIANO SCAPIN

I understood these crime organizations' primary objective is to make money. Are these crime organizations primarily concerned with economic gain, or do they have other objectives like territory control, terrorism or political destabilization?

— JEROLD ZIMMERMAN

Many criminal organizations have objectives beyond making money, such as providing safety and prestige for its members. People form organizations because there are gains to trade. That's what we teach in economics.

Consider why people form a church. The objective of the church is not to make money. It's for people to gather and exercise their religion. To do that, they must acquire resources for a building to hold services. They must have resources to acquire a priest or a clergyman. And so those organizations, to survive, must provide the members of the church value for the time and money the congregates contribute to the church. And so, they must have incentive systems to make sure, for example, that they hire the right priest, and the priest shows up and that they have resources in place for collecting money during the religious services. They need control mechanisms in place to prevent the theft of the Sunday church collections. A church's primary objective is to survive by providing congregates services they value, not to make money. If it can't provide value, people stop contributing to the church and it cannot survive.

— MARIANO SCAPIN

We have one question from the audience. Do you believe the four pillars have different importance based on the type of organization? Are the four pillars more important in criminal organizations than in for-profit, legal profit-seeking organizations?

— JEROLD ZIMMERMAN

That's a good insight. The four pillars are critically important in ALL organizations. But the relative importance of each pillar will vary across firms. My key point about the four pillars is "One size does not fit all." Each legal and illegal organization must develop a set of pillars that best implements that organization's unique strategy. Let me give you an example. Some of the most elite Institutions that we have in the United States are our military academies. We have the Air Force Academy, West Point for the Army, and the Naval Academy at Annapolis. These institutions train our future military leaders. And to them, the most important of the four pillars is the culture pillar. People who want to go into the military as a career, are doing so for love of country and for their patriotism. And so, the military academies go to great lengths to instill a culture of loyalty, duty, honor, integrity and courage. They screen applicants based on their personal values. And then during the four years that the cadets attend these military academies, they weed out individuals who don't have those values. The objective of our armed services and the officers of these services is the protection and security of the United States. And the four pillars of our military and our military officers strongly encourage patriotism and duty to the country.

So that's an example of organizations that place a lot of weight on the culture pillar, and it really doesn't put all that much weight on monetary rewards. The military rewards officers (and enlisted personnel) by promotions and assignments to important command positions. Officers get a lot more prestige being a "general" than a "captain."

— MARIANO SCAPIN

We have another question from the audience. You mentioned Al Capone in your presentation. What are your views on the relation between corruption and crime, corruption-related crime and accounting research? What is the role of accounting research in how to address corruption-related crimes?

— JEROLD ZIMMERMAN

Well, clearly there is a literature in accounting on earnings management, and when earnings management crosses the line to fraudulent reporting. At least in the United States, it's hard to get data on corruption because by its very nature, it's not publicized, it's not in the public record. I'm sure there's interesting research questions in this area. The question is, where do we get the data?

— MARIANO SCAPIN

Related to this, I would like to recommend for those interested the paper by Bianchi et al. (2021). These authors find evidence that Italian firms that are connected to organized crime are likely to harm their shareholders through poor performance.

Thank you, Professor Zimmerman, for your answers.

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