

An Empirical Study on the Impact of Banking Frauds in the Development of Indian Economy: With Special Reference to Public Sector Banks

Pooja M

Assistant Professor, Department of Commerce, Smt & Sri Y.E.R. Government First Grade College, Pavagada, Tumkur-561202

Abstract

Finance is the life blood for every economic activity. In providing finance and development of Indian economy banking sector is playing vital role. The Indian banking sector experienced significant growth and challenges since liberalization of Indian economy in 1991. Though the banking sector is well regulated and supervised by RBI, the sector is suffering from its own set of challenges. Fraud is a worldwide phenomenon that affects all sectors of the economy. With the rapidly growing banking sector in India, frauds are also increasing, and also fraudsters started to use innovative techniques. Shockingly banking sectors are showing frauds as NPA's. The study tries to identify the different route causes for the happening of frauds in the Indian banking sector, there are; work pressure to staff, lack of training, industry competition, family pressure, and low degree of compliance with the guidance of RBI issued time to time and very importantly, internal control system (managers are involving in frauds).

There is no “one silver bullet” to stop all frauds always. Frauds are emerging risks in the financial sector. When it comes to number of fraudulent cases, over 23,000 cases of fraud involving of whopping of Rs. 1 lack crore have been reported in the past five years in various banks. A total of 5,152 cases of fraud in banks were reported in April 2017 to March 1, 2018 over 5,000 cases in 2016-17, according to RBI reply to an RTI query (RBI). The Indian banks should take rising trends of bank frauds seriously and also there is no negligence on the part of bank employees in internal control system. However, technology can play a key role in combating banking frauds: proactive forensic data analysis and data mining techniques can help governments, regulatory bodies and Banks to counter the increasing banking frauds in India.

Keywords: finance, Indian economy, banking sector, banking fraud, RBI regulations, technology usage, NPA's.

Introduction

Banking is the lifeblood of every nation and plays a vital role in activating and sustaining the economic growth. Banking facilities include providing the facility of deposits, withdrawals, transfer of money borrowing facilities and many more financial facilities. Banks provide advances to individuals, firms, corporate for availing their financial needs such as loan for house, conveyance or loan for working capital facilities, expansion of business etc. There are number of reasons for which bank provides the impress facility for the betterment of the individuals, business and economy. In India the public sector banks playing important role in providing financial assistances to individual, corporate entities including MSMEs. The Indian public sector banks are fastest growing banks in the world top banks list. The public will believe in more than private sector banks.

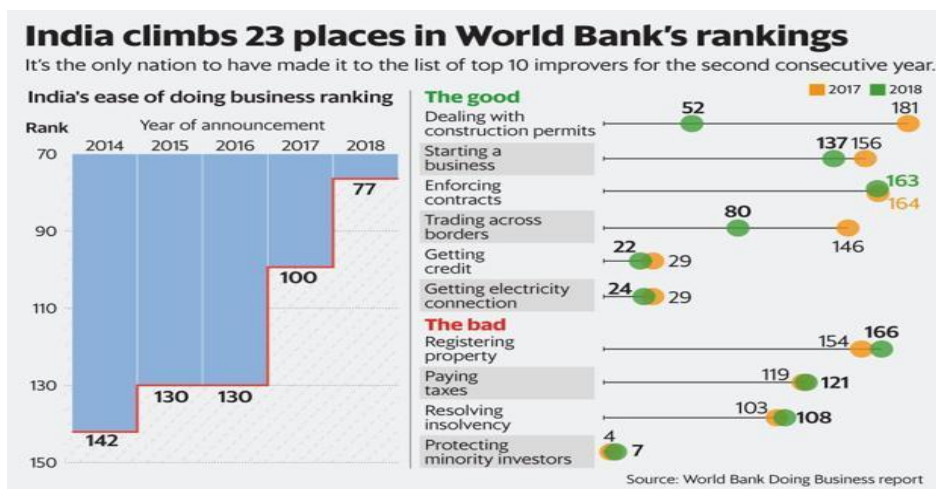


Figure 1: World Bank's ranking

History of Banking in India

The Concept of Banking in India came up in early 18th century. The first bank that was established in the country was The General Bank of India in 1786, which Was totally a Government Undertaking bank. It was neither among the Public Sector Banks in India nor Private sector banks in India. After that State Bank of India established in Kolkata in 1806 which was then known as The Bank of Bengal. Reserve Bank of India is The Governing Body of Banking in India. All The Indian Banks and their operations are controlled by Reserve Bank of India (RBI). This governing body took over the responsibility of legally regulating the Indian banks in 1935. The Indian banking sector is broadly classified into scheduled and non-scheduled banks. The scheduled banks are those included under the 2nd Schedule of the Reserve Bank of India Act, 1934. The scheduled banks are further classified into: nationalised banks; State Bank of India and its associates; Regional Rural Banks (RRBs); foreign banks; and other Indian private sector banks. The term commercial bank refers to both scheduled and non-scheduled commercial banks regulated under the Banking Regulation Act, 1949. The banking sector in India is probably the most successful sector. It is also denoted as the leading and most powerful sector of the Indian economic system. In this system, more than 75% of market share is held by the public sector banks. There are 22 public sector banks in India, as of 2019.



Figure 2: Growth in deposits over the past few years.

In recent years, cases of financial fraud have regularly been reported in India. Although banking frauds in India have often been treated as cost of doing business, post liberalization the frequency, complexity and cost of banking frauds have increased many resulting in a very serious cause of concern for regulators, such as the Reserve Bank of India (RBI). RBI, the regulator of banks in India, defines fraud as “A deliberate act of omission or commission by any person, carried out in the course of a banking transaction or in the books of accounts maintained manually or under computer system in banks, resulting into wrongful gain to any person for a temporary period or otherwise, with or without any monetary loss to the bank”.

In the last three years, public sector banks (PSBs) in India have lost a total of Rs. 22,743 crore, on account of various banking frauds. With various measures initiated by the RBI, numbers of banking fraud cases have declined, but amount of money lost has increased in these years. Prima facie, an initial investigation in these cases has revealed involvement of not only midlevel employees, but also of the senior most management as was reflected in the case of Syndicate Bank and Indian Bank. This raises serious concern over the effectiveness of corporate governance at the highest echelons of these banks. In addition, there has been a rising trend of non-performing assets (NPAs), especially for the PSBs, thereby severely impacting their profitability. Several causes have been attributed to risky NPAs, including global and domestic slowdown, but there is some evidence of a relationship between frauds and NPAs as well.

Concept of Fraud

“There are three things in the world that deserve no mercy - hypocrisy, fraud and tyranny.”
-Frederick William Robertson. The saying indicates how dangerous frauds are for the society,

especially in financial terms. The Oxford dictionary defines fraud as a wrongful or criminal deception intended to result in financial or personal gain.

Fraudulent activities may result in benefits for a very small fraction of the population, but at times the volume of these frauds amount to alarming numbers. Cressey (1973) developed a model for explaining the factors that cause someone to commit occupational fraud and named it fraud triangle. It consists of three components which, together, lead to fraudulent behavior: Perceived unshareable financial need, Perceived opportunity and Rationalization.

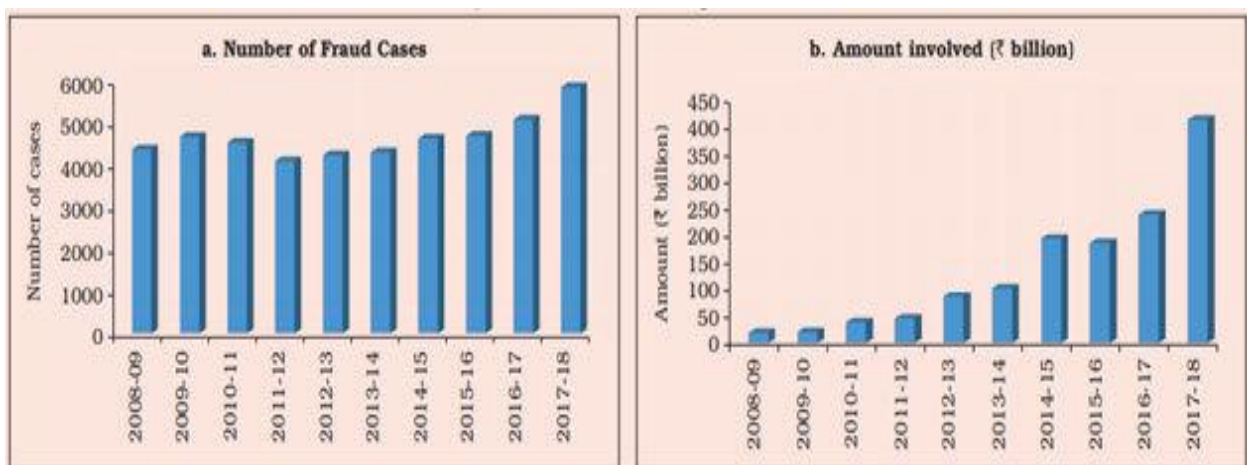
Fraud is any unfair act and behavior by which one person gains or intends to gain an advantage over another person. The gain may accumulate to the person himself or to someone else. Fraud causes loss to the victim, directly or indirectly. In conceivable terms bank frauds include all sort of misappropriations, pilfering, and manipulations of negotiable instruments (cheques, drafts, hundies, bills or statements of accounts, securities etc.). Fraud also includes misrepresentations, cheating, thefts, gratuitous favors and irregularities. The word fraud has been defined in law in the Indian Contract Act, section 17: ‘Fraud’ means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agent, with intent to deceive another party thereto or his agent, or to induce him to enter into the contract:

1. The suggestion as a fact, of that which is not true, by one who does not believe it to be true;
2. The active concealment of a fact by one having knowledge or belief of the fact;
3. A promise made without any intention of performing it;
4. Any other fact fitted to deceive;
5. Any such act or omission as the law specially declares to be fraudulent.

Fraud in the financial services sector poses a significant risk to institutions and veracity of capital markets. Its effects can be widespread and cause not only long term financial but also reputational damage. According to the survey financial sector is most vulnerable to fraud as compared to other sectors. Moreover, the cost of fraud does not stop at a monetary figure; it is deceptive in nature, has other serious implications including:

- Reputation risk
- Adverse regulatory and media attention
- Reduced profits
- Decrease in company value/share price
- Decreased efficiency of employees

The Institute of Internal Auditors “International Professional Practices Framework” (2009) defines fraud as, “Any illegal act characterized by deceit, concealment, or violation of trust. Frauds are perpetuated by parties to obtain money, property or services; to avoid payment, or loss of services; or to secure personal or business advantage.” It should be noted that frauds generally impacts a bank by causing financial, operational or psychological loss.



Source: RBI Supervisory Returns.

Figure 3: No. of fraud cases and amount involved.

Types of frauds

- Stolen checks
- Cheque kiting
- Forgery and altered cheque
- Accounting fraud
- I. Uninsured deposits
- II. Demand draft fraud
- Rogue traders
- Fraudulent loans
- Fraudulent loan applications
- Forged documents
- Wire transfer frauds
- Bill discounting fraud
- Payment card fraud
- Empty ATM envelope deposits
- Prime bank fraud
- Phishing and internet fraud
- Money laundering

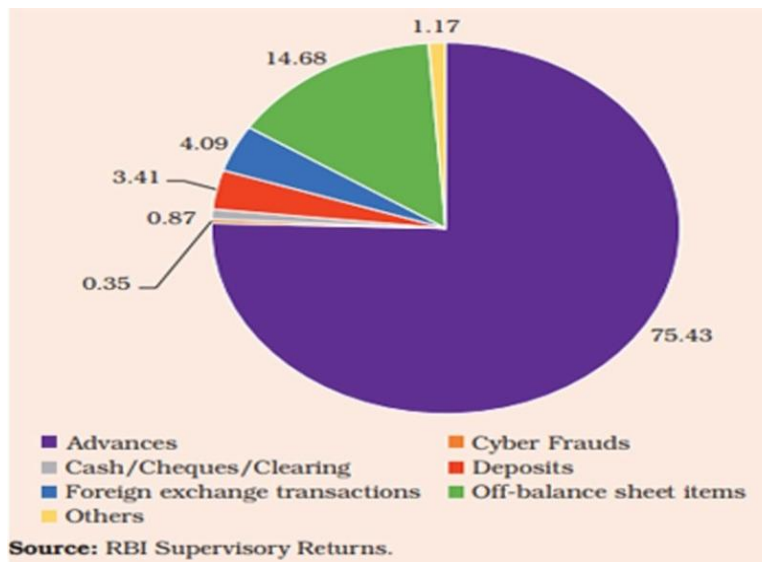


Figure 4: Share of different kinds of frauds in Indian banking sector Frauds.

A recent RBI report reveals that fraudsters plundered around Rs 41,167 crore from the banking system in the financial year 2017-2018, a sharp rise of 72 per cent over the previous financial year. In the year 2016-17, the overall frauds in the banking system accounted for Rs 23,933 crore. The Reserve Bank of India report, declares total 5,917 fraud cases were reported in various banking operations in the year. Of this, maximum 2,526 were advances related cases, while 2,059 were cyber frauds.

"In 2017-18, however, frauds related to off-balance sheet operations, foreign exchange transactions, deposit accounts and cyber-activity have taken the centre stage," the report said.

RBI Guidelines for Fraud Cases

The RBI requires banks to follow fraud cases dynamically with the CBI or police authorities, and in court. In the case of PSBs, all fraud cases below Rs. one crore should be reported to the local police, except when the CVO and CMD consider it serious, and when the cases cannot be classified in monetary terms, in those cases, the frauds are stated to the CBI. Cases above Rs. one crore must be referred to a different wing of the CBI depending on the category it falls into. In the case of private-sector banks, frauds of Rs. one lakh and above committed by an outsider, in connivance with a bank official should be referred to the local police. DNA (2012) found that in many of the cases the banks do not follow the RBI guidelines.

Review of literature

Dr. Madan Lal Bhasin (2015) in his study entitled – “An Empirical Study of Frauds in the Banks” stated that, Banks are the engines that drive the funds into the financial sector, money markets and growth of an economy. With the speedily growing banking industry in India, frauds in banks are also increasing very fast, and fraudsters have started using advanced means to escape from the frauds. Though banks cannot be 100% secure against unidentified threats, a certain level of attentiveness can go a long way in disputing fraud risk. “Rising number of frauds in Indian banks are taking place due to collective failure of regulatory oversight system comprising of external auditors, audit committee, internal audit system, board of directors, independent directors, shareholders, etc. All regulatory and investigative agencies must work in close collaboration and share their inputs and databases with each other in order to prevent frauds.”

Anju Rohilla, et.al. (2017) in their study entitled – “Combat Loan & Advance Related Frauds –A Study of Indian Banking Sector” stated that, Frauds related to loan and advances occupy the major share in the total number of bank’s fraud i.e. 64% of the total amount involved in the total frauds. The loan and advance related frauds show that there is remarkable rise in the past years. This research paper is keen towards identification of the measures to fight with frauds specifically loan & advance related fraud in the banking sector of India. The case study methodology has been used to accomplish the objective of the study. This study found that the advance related fraud result into increase in the NPA’s (Non Performing Assets). On the basis of the entire study a framework is proposed for the early detection of the fraud. Banks need to follow such framework in detection and revention of banking frauds.

Sukanya Kundu and Nagaraja Rao(2014)in their study – “Reasons of Banking Fraud – A Case of Indian Public Sector Banks” depicts that, The number of bank frauds in India is considerable and it is increasing over a period time and technology. According to a survey by Ernest & Young, 2012 the banking segment witnessed around 84% of reported fraud cases within the financial services sector. The study covered the different cases of frauds, map a typological trend approach to be adopted to prevent frauds by implementing strategies and present the same for implementation with possession. This case study was based on the primary data gathered from a nationalized bank in India. it can be said that, however adoption of technology comes with the evolution of time, but protection of public money and people is the greatest challenge and responsibility of a modern day banker.

Dr. S Venkata Ramana, Dr. S Gopi Krishna (2017) in their study entitled – “A study on impact of fraud in Indian banking sector (With special reference on retail banking products)” mentioned that, Banking sector frauds have been in existence for centuries, with the initially known frauds relating to insider trading, stock manipulation, accounting irregularity/ inflated assists etc. As retail banking has more process as well as volume-driven, increased fraud cases in this area should activate a wider review of the process and controls to identify the root cause as these cases could be just the tip of the iceberg. In this paper an attempt was made to understand the meaning of fraud, fraud triggers, how to identify and control fraud in retail banking products.

Neha Sharma Dr. Dhiraj Sharma (2017), in their study titled – “An Empirical Study on Banking Frauds in India- with a special reference to role of Employee Awareness in Banking frauds” depicts the part of frauds from the standpoint of handling and managing the banking sector. The study tried to figure out the different reasons liable for the occurrence of frauds in the Indian Banking Sector. The study highlights the different causes responsible for fraud cases in banks and these reasons are work pressure on staff, insufficient trainings, industry competitiveness, family pressure and low degree of compliance followed as issued by RBI time to time. The study also recommend the measures to be taken to avoid the occurrence of frauds.

Dr. Sukhamaya Swain, Dr. Lalata K Pani (2016), in their study entitled – “Frauds in Indian Banking: Aspects, Reasons, Trend-Analysis and Suggestive Measures” stated that, Frauds in Indian banking have been seen a rising trend over the last few years. The statement is just basis to know the cases reported by member banks in India and there is the unraccountable figures could be still higher. Against this framework and together with rising NPAs and more usage of alternate technological modes of baking, it is essential to banks to relook at the time of fraud and amount of attention that they are giving to frauds and proactive measures to prevent the same. This paper discussed the various facets of frauds in Indian banking system. It evaluates the statistics involved with fraud based on secondary data available from reliable sources and also analyses the same. Each of the types namely KYC related, loan related and technological aspects are discussed in details along with the reasons. At the end, some suggestions are placed for banks to practice.

Research Design

Statement of the problem

The banks holds a great obligation towards the society as the banks are most trusted establishment among the society. The larger society expects highest accountability, fairness, transparency and effective collabation from banks. For the attainmentof public trust and goodwill it is essential that the banks must carry out their operations with great responsibility and earnestness of purpose. Management of fraud is very essential element in banking sector.. The research work is all about identifying the reasons responsible and measures to be taken to prevent the frauds in Indian Public Sector Banks and proposing possible solutions to the problem.

Objectives of Study

1. To know the role played by the public sector banks in Indian economy.
2. To analys the different frauds in PSBs.
3. To identfiy the causes for frauds in banking industry.
4. To identify the impact of frauds on Indian banking sector.
5. To know the perception of bank employees towards frauds and their compliance.
6. To evaluate the present mechanism of prevention of frauds.
7. To identify the better methodology and measures to prevent frauds in banking sector.

Hypothesis

Null Hypothesis (H_0): There is a no significant relationship between banking frauds and their degree of compliance towards frauds

Alternative Hypothesis (H_1): There is significant relationship between banking frauds and their degree of compliance towards frauds

Null Hypothesis (H_0): There is a no significant impact of banking frauds of PSBs on Indian economy

Alternative Hypothesis (H_1): There is significant impact of banking frauds of PSBs on Indian economy

Sources of Data

The study conducted by getting information through these sources. The sources are primary data and secondary data.

Primary data:

Primary data collected from:-

→ Information collected through the questionnaire from banking employees including managers, cashiers, clerks, etc.

→ Interview schedule is another tool which is used for collecting information from banking employees.

Secondary data

The study includes secondary data collected from various reports like RBI reports, articles published in journal, newspapers, RBI publications, etc.

SAMPLE DESIGN

Sampling technique

The study conducted by using random sampling and convenient sampling method based on availability and response of the banking employees.

Sampling size

The study's sampling size is 100 bank employees of SBI, Canara bank, Syndicate bank and Vijaya bank in Pavagada, Madhugiri and Koratagere- Tumkur district.

Data Analysis and Interpretations

Table 1: Compliance Level of Bank Managers about various heads of operations

	Internal control and audit	Loans and advances	Deposit account	Admini. of cheque&pass book	Draft section	Internal & inter-branch account
Compliance score	92%	90%	79%	60%	84%	83%

Source: Field Study

Table 1 depicts the average compliance score of Bank Managers under the various heads. The results show that Bank Managers compliance level is the lowest (60%) in administration of check/pass book. In sharp contrast, the highest (92%) compliance is noticed in internal checks and audit. The Managers gave second highest (90%) importance to loans and advances, and gave almost equal importance to the draft section (84%), internal and inter-branch account (83%), and deposit account (79%), respectively.

Table 2: Attitude of Bank Employees towards RBI Procedures

Attitude	Favourable	Moderate	Unfavourable	Total
Total no. of employees	15	23	62	100

Source: Field Study

Table 2 shows that a “very high proportion of respondents (62) believe that they do not have sufficient staff to carry out the work accurately, they are usually overburdened with work and hence, not able to follow the procedures strictly. Very less proportion (15) agreed that, they can follow RBI procedures.

Table: 3 Response of the Bank Employees on the basis of their Awareness Level

Awareness Category	High		Medium		Low		Total
	Response	%	Response	%	Response	%	
Manager	2	20	3	30	5	50	10
Officers	7	20	12	34.29	16	45.71	35
Cashier	5	16.67	10	33.33	15	50	30
Clerk	3	12	9	36	13	52	25

Source: Field Study

It is clear from Table: 3, the awareness level is very low about frauds among bank employees. A careful study of the data contained in the table reveals shockingly that about 52% of clerks, 50% of cashier, 45.71% of officers and 50% of Managers belong to “low” category of awareness level. It is very disappointing to know that the awareness level of Bank employees about various types of frauds and losses suffered by the banks are very low.

Table: 4 Score given by Bank Employees to the Various Reasons for Occurrence of Frauds in Banks. (For 10 points)

Position	Lack of training	Corrupt officer in-charge	Overburdened staff	Competition	family pressure
Managers	8	3	6	4	5
Officers	6	4	7	3	4
Cashier	6	5	5	4	3
Clerk	7	4	6	3	4

Source: Field Study

Table 4 depicts the relative importance (on 10 point score) assigned by the Bank Managers, Officers, cashiers and Clerks to the reasons responsible for the commitment of bank frauds. All the position in bank gave more weight-age to lack of training, and followed by overburdened staff. The least weight-age is given to competition by banking employees.

Table 5: Requirement of Advanced Training in Prevention of Bank Frauds

	Yes		No		Not Applicable	
Position	Response	%	Response	%	Response	%
Manager	4	9.09	3	7.89	3	16.67
Officers	18	40.91	10	26.32	7	38.89
Cashier	12	27.28	15	39.47	4	22.22
Clerk	10	22.72	10	26.32	4	22.22
Total	44	100	38	100	18	100

Source: Field Study

From table 5 we came to know that majority of the respondents (44) said that there is a requirement of advanced training related to prevention banking frauds in India and least (20) respondents said that not applicable, and 38 respondents said that there is no requirement of any training in prevention of frauds.

Table 6: Bank Employees Response towards Practicability of Compliance with RBI’s Procedure to carry out day-to-day Operations of Bank

Position	No		To Some Extent		To Large Extent		Yes	
	Response	%	Response	%	Response	%	Response	%
Manager	2	9.09	5	10.2	3	20	2	14.28
Officers	7	31.81	17	34.69	6	40	5	35.72
Cashier	8	36.37	15	30.61	3	20	2	14.28
Clerk	5	22.73	12	24.48	3	20	5	32.72
Total	22	100	49	100	15	100	14	

Source: Field Study

Table 6 depicts that majority of respondents (49) said that, to some extent it is difficult to follow the procedures given by RBI to carry out day-to-day operations of bank. And the least (14) respondents said that, they can follow the procedures prescribed by RBI.

Findings

1. The compliance level of bank employees towards various heads of transaction is different. They will give more importance to internal check and audit and lowest care taken for administration of cheque book and pass books.
2. Majority of the respondents (62) believe that they do not have sufficient staff to carry out the work accurately, they are usually overburdened with work and hence, not able to follow the procedures strictly. Very less proportion (15) agreed that, they can follow RBI procedures.
3. It is very disappointing to know that the awareness level of Bank employees about various types of frauds and losses suffered by the banks are very low.
4. The main reason for increasing number of frauds in public sector banks, according to bank employees is lack of advanced training in identification and prevention of banking frauds.
5. From the study it is also clear that the banking frauds occur due to ignorance, situational pressures and lenient attitudes and their own benefits (bribes).
6. It is difficult to detect fraud in time and even more difficult to book the offenders because of complex and lengthy legal/judicial requirements and processes.
7. In the banking sector there is a fear of harming the banks reputation. Because of this reason so many frauds will not come to picture.
8. Delay in detection and reporting to the regulatory and inspection agencies and in the action taken against the payment, the fraudsters have also been causing concern.
9. Corrupt bank officers join their hands with the fraudsters and they are not worried about the public money and role of banks played in the development of Indian economy.
10. These are the frauds which came into picture and there are so many frauds which didn't brought to light of regulatory agencies.
11. It was identified that staff attitude towards the RBI procedures regard to day-to-day workings are too lengthy and very complex to follow.

Suggestions

1. Bank employees should take at most care while lending the loans and advances and they should give almost same importance to all the heads of transactions.
2. It is relevant to know your employee (KYE). Extra due diligence and caution to be exercised for employee's recruitment.
3. From the study came to know that, staff are not aware about frauds and there is need to create awareness about different types of frauds.
4. The main reason for frauds is lack of training. Hence, there is a need of advanced training program required for the prevention of banking frauds.
5. RBI or regulatory agencies should develop simple and systematic frame work for frauds detection and prevention.
6. It is very essential to upgrade the policies governing Know Your Customer (KYC). Need to verify and evaluate the borrower's background and financial stability.

7. RBI needs to develop a framework in such a way that banks can easily detect and prevent banking frauds in public sector banks.
8. The risk management system of the bank should be improved. The bank had been constantly hit by frauds which indicate the internal risk management is very fragile and non-planned.
9. Banks should take severe action against fraudster by lodging compliant against them
10. Need to create awareness among bank customers about banking frauds and impact of those on economy of a country.

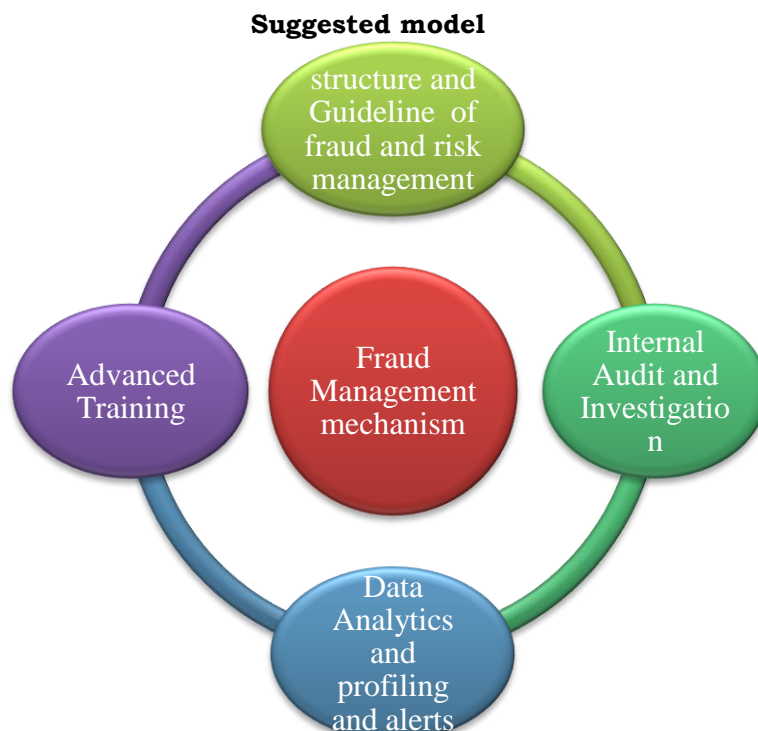


Figure 6: Suggested Module for Fraud management Mechanism

Conclusion

While the banking industry in India has perceived a solid growth in its total business and profits, the amount involved in bank frauds has also been increasing. This corrupt development in the banking sector produces not only losses to the banks but also affects their credibility adversely (Kaveri, 2014). While fraud is not a subject that any institution wants to deal with, the reality is that most organizations experience fraud to some degree of level. The bank employees do not give due importance to the problem of frauds. The awareness level of bank employees regarding bank frauds is very low and not satisfactory and majority of them do not show favourable attitude towards RBI procedures as they find trouble in following them due to workload and pressure of competition. Moreover employees are not well trained to prevent bank frauds. Training positively affects the compliance level of employees and improves the attitude towards RBI's procedure. There is a need to upgrade banks in advanced technology in detection and prevention of frauds.

Reference

1. Dr. Madan Lal Bhasin (2015), An Empirical Study of Frauds in the Banks, *European Journal of Business and Social Sciences*, Vol. 4, No. 07, P.P. 1-12.
2. Sukanya Kundu, Nagaraja Rao (2014), Reasons of Banking Fraud – A Case of Indian Public Sector Banks, *International Journal of Information Systems Management Research & Development (IJISMRD)*, Vol. 4, Issue 1, Jun, P.P. 11-24.
3. Dr. S Venkata Ramana , Dr. S Gopi Krishna (2017), A study on impact of fraud in Indian banking sector (With special reference on retail banking products), *International Journal of Academic Research and Development*, Volume 2; Issue 6; November; P.P. 544-547.
4. Neha Sharma, Dr. Dhiraj Sharma (2017), An Empirical Study on Banking Frauds in India- with a special reference to role of Employee Awareness in Banking frauds, *International journal Of Business Management*, VOL. 3 Issue 1.
5. S. Gayathri, T. Mangaiyarkarasi (2018), A Critical Analysis of the Punjab National Bank Scam and Its Implications, *International Journal of Pure and Applied Mathematics*, Volume 119 No. 12, P.P.14853-14866.

6. Dr. Sukhamaya Swain, Dr. Lalata K Pani (2016), Frauds in Indian Banking: Aspects, Reasons, Trend-Analysis and Suggestive Measures, *International Journal of Business and Management Invention*, Volume 5 Issue 7, PP—01-09.
7. Charan Singh (2016), Frauds in the Indian Banking Industry, *IIMB*.
8. Ashu Khanna & Bindu Arora (2009), A study to investigate the reasons for bank frauds and the implementation of preventive security controls in Indian banking industry, *International Journal of Business Science and Applied Management*, Volume 4, Issue 3.
9. Anju Rohilla, Dr. Ipshita Bansa (2017), Combat Loan & Advance Related Frauds –A Study of Indian Banking Sector, *International Journal of Research in Finance and Marketing (IJRFM)*, Vol. 7 Issue 6, June, pp. 26-36.
10. Dr. Madan Lal Bhasin (2015), Menace of Frauds in the Indian Banking Industry: An Empirical Study, *Australian Journal of Business and Management Research*, Vol.4 No.12.
11. Pasricha, P. and Mehrotra, S. (2014). Electronic Crime in Indian Banking, *Sai Om Journal of Commerce and Management*, 1(11), November.