

Analysis of Corporate Frauds in the Indian Banking Sector

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Abstract:

The Banking Sector is the key sector for the country's overall development as it provides monetary resources for the needy, which includes retailers and corporates. The banking sector plays a vital role in improving our nation's GDP and we have witnessed the same since nationalization and liberalisation of our banking sector. At the same time, we have witnessed many fraud cases hit the news headlines and as per RBI reports, Indian banks have lost Rs. 5.74 lakh crores during the past decade and frauds by corporates contribute lion's share in those figures. In this regard, our study analyzed the top fraud cases by corporates and suggested preventive measures for the same. We have reviewed fraud data taken a review period for the years 2013-2023 for our study and a sample from 146 bank employees from various banks. We have used content analysis to fulfill the objectives of this study. Our study found that political and bank top management pressures causes deviation in the bank's guidelines and also it was revealed that corrupt practices by bank staff are observed in some of the cases.

Key Words: Banking sector, Corporate fraud, Nationalization

Introduction:

The roots of banking operations in our country were observed in the late eighteenth century and since then the landscape of our banking sector has been evolving as per the requirements of people. During the initial period, there were many bank failures were witnessed due to a lack of proper management in their functioning, and only a few succeeded, however, most of the citizens depended on local money lenders to cater to their needs. After the Post-Independence era, our policymakers decided to nationalize a few existing private banks to take banking services to rural areas and to give a major thrust to the agriculture sector initially later it was spread to support the industrial sector upon layout made in five-year plan. Later, liberalization policy was brought to curtail monopoly and ease norms, all these policy-making decisions were successful in their implementation as almost every citizen has having bank account and greater financial inclusion took place.

At the same time, fraud cases have enormously increased over the past few years, out of which many big-ticket loan frauds have hit the headlines during the past decade. Indian banks have suffered a major loss due to fraudulent acts from the corporate sector as per amount wise despite the cases being fewer. The fact remains that the territory sector contributes a major share of our country's GDP and enhances our productivity year on year, however, from the same sector many of the corporate frauds were reported. As per the RBI reports, Indian banks have reported 3,67,845 fraud cases amounting to nearly Rs.5.74 lakh crores, out of which, Rs.75,912 crores fraud amount is from eight individual corporate accounts. Hence, our study analyses those eight top corporate fraud cases in the banking sector and finds out the factors that contribute to the same.

Literature Review:

Corporate frauds:

One of the main problems for fraud occurrences in our banking industry is corruption and if it is not identified at the budding stage, it will spread to entire corners of the financial system. Due to laxity in systems, white-collar crimes like PNB fraud, and King Fisher Airlines fraud are increasing in the banking industry nowadays. Dual or triple control systems to be effectively implemented in banking transactions and continuous monitoring of corporate accounts will give better results in preventing fraud (Dogra, A., 2018). Public money is not even safe in banks' hands since a lot of scams have been revealed in the past few years. The contributing factors to be identified and internal audit to be reviewed in every public sector bank to prevent corporate fraud. Also, it was revealed that to absence of proper internal control in banks causes massive fraud cases (Uke, L, 2018). The Indian banking sector is now facing major challenges regarding its lending as an outside influence (political pressures) and other issues in management lead sanctioning of certain corporate advances, finally, it leads to NPA in a way of fraud. Recovery chances of any non-performing asset are very tough for banks to get the entire dues, hence, banks must scrutinize high-value advances properly before it sanctioned. (Sharma, G.V.K.R, 2022).

The nature and causes of corporate fraud were studied in one of the studies and it was found that the regulatory system in the existing companies is vague and there is an urgent need to review the role of auditors. Further, coordination is not up to the mark among various regulatory bodies. In financial institutions, a lack of proper due diligence and effective management at the top level causes fraud. (Gupta, P.K. & Gupta, S. 2015). Banking organizations are facing challenges such as failure in management supervision, and insufficient actions against warning signals leading to financial fraud. Other factors such as weak operational control, lack of risk management, and lack of segregation of tasks between front and back-office lead to high risks of financial fraud within a banking organization (Willson, R, 2006).

Factors that influence fraud:

Fraud cases are increasing every year despite several acts and regulations that exist for its functioning. Unethical practices by various parties involved in the bank transactions result in loss of public money, also bank fraud occurs mainly due to a lack of skilled employees, technical advancement, political pressures, unethical acts, and absence of proper monitoring (Singh, G & Kaur, S, 2023). The Indian banking sector has undergone major changes after the post-independence era as new avenues opened in our banking sector and major growth was observed. Over with the changes, new challenges have emerged for its functioning (Kaivalya, B et al., 2021). It was discussed that frauds committed by employees depend on the employee's personal situation and work pressure. The cited reasons were any financial credits or losses on personal ends, societal pressure, and low satisfaction from the current job due to high pressure, which can raise the situation of fraud committed by employees at the workplace. It was stated in the study that 95% of the total reviewed cases were due to the financial difficulties at the personal end of the fraudsters. It was found that the pressure on fraudsters either job pressure or social pressure can push them to commit fraud (Hillison et al., 1999). In one study, it was revealed that the causes of many frauds are due to the negligence of the bank's supervisory staff. Further, it was stated in the study that supervisory staff at the branch level need to control the above types of fraud (Sharma & Brahma, 2000). The environmental factors that enhance the probability of embezzlement, are inadequate rewards; inadequate internal controls; no separation of duties or audit trails; ambiguity in job roles, duties, responsibilities, and areas of accountability; failure to counsel and take administrative action when performance levels or personal behavior fall below acceptable levels; inadequate operational review; lack of timely or periodic review, inspections, and follow-up to assure compliance with company goals, priorities, policies, procedures, and governmental regulations and failure to monitor and enforce policies on honesty and loyalty (Bologna, 1993).

Internal control & Preventive measures:

Various factors including opportunity and pressure cause many fraudulent activity in financial institutions as this sector is a very sensitive target for fraudsters. The authors have analyzed various papers about the period between 2000-2021 years. Also, it was mentioned that non-monetary damage occurs apart from financial loss due the fraudulent acts in banking. (Mangala, D & Soni, L, 2022). The banking sector has been flourishing for the past few years, however, on the other side its efficiency is severely affected due to numerous fraudulent acts reported. Existing legal measures in the Indian Penal Code (IPC) are sufficient to tackle fraudsters if they implement properly. (Sravanthi, M & Bhargavi, CH, 2023). A typology of individuals who embezzle was explained. He indicated that embezzlers are "opportunistic type", who quickly detect the lack of weakness in internal control and seize the opportunity to use the deficiency to his benefit. To deter embezzlement he recommended the following measures:- Institute strong internal control policies, which reduce the opportunity for crime, and Conduct an aggressive and thorough background check before employment (Smith, 1995). Public sector banks were badly affected by fraudulent cases, particularly frauds reported by Punjab National Bank was reviewed and it was revealed that the bank's loan quality was not up to the mark as per regulations. Further, it was mentioned that banks are facing numerous challenges in combating fraudulent activities (Rajpal, R & Rajpal, T, 2022). Innovative technological upgradation has brought significant changes in bank's functioning and also with the use of the same technology, fraudsters defraud banks and flew away from the country to escape from legal proceedings. In this regard, banks must engage their existing fraud risk management to curtain frauds (Mishra, D & Jaiswal, B.K, 2022). Internal auditors of financial institutions have only nominal direct legal liability, indirect liability is inferred. To protect this opportunity, the audit department must substantiate its "due diligence" activities by defining the essential elements of internal controls and routinely conducting audits in high-risk areas. The study provides a list of the audit frequencies proposed and the required internal controls for some of the banking industry's most vulnerable areas. These recommendations can be useful for audit departments to prepare and schedule their operations, as well as to assist organizations in minimizing external audit fees that would otherwise be needed in an environment of poor internal control (Chang, S.Y. & Morris, R.E., 1993). The fraud management lifecycle can be used to encapsulate the process of fraud prevention. This cycle consists of eight stages, including deterrence, prevention, detection, mitigation, analysis, policy, investigation, and prosecution. The deterrence stage involves activities that hinder or discourage fraud through fear of consequences. On the other hand prevention activities hinder, check, keep away, or stop the fraudster from committing fraudulent activities (Wilhelm, 2004). Fraud was categorized into management fraud and employee fraud. Management fraud is committed by managerial employees and consists of, but is not limited to: Financial Statement fraud,

misrepresentation of material facts, misappropriation of assets, concealment of material facts, illegal acts, bribery, corruption, and conflict of interest (Elliot & Willingham, 1980).

Objectives:

- 1) To analyze top corporate bank frauds
- 2) To find out the factors that influence corporate frauds from a bankers perspective

Methodology:

We have analyzed news articles, websites, survey reports, and existing literature work on the said subject for concluding the first objective of our paper. We have interviewed 146 employees from various banks through simple random sampling, which includes State Bank of India, Bank of Baroda, Canara Bank, Axis Bank, ICICI Bank & Karur Vysya Bank and we have used content analysis to fulfill the second objective of the paper.

Results & Discussion:

Our study analyzed the top eight corporate frauds in the banking industry and we have analyzed every aspect of the following fraudulent case and explained the modus operandi of each case, amount of fraud, and perpetrator of fraud, and mainly our study discussed the contributed reasons that cause's fraud from the bank's point of view.

1. Vijay Mallya Fraud Case

- Background: Vijay Mallya was a famous businessman who was well known for his brewery business and later established an airline company named Kingfisher his firm borrows money from 17 various banks out of which SBI is the largest lender. Public sector banks lend most of his advances.
- Year of Fraud Reporting: 2016
- Fraud amount: Rs.9,000 crores (approx)
- Modus Operandi: The main deviation committed by the firm is "funds diversion" as the company diverted bank funds for a different purpose i.e. other than the lending purpose. The company failed to repay its advances upon losses incurred in the airline's business. Further, he obtained loans beyond his capacity by using his political influence
- Causes:
 - a) Lapse in effective internal control in banks includes improper appraisal and monitoring.
 - b) Effective fraud management strategy.
 - c) Huge sector concentration in the bank's advances portfolio.
- Perpetrators: Customer (Vijay Mallya)

2. Nirav Modi Fraud

- Background: Nirav Modi is a then renowned businessman whose main line of activity was a diamond merchant, to obtain credit for his diamond import, he was issued with multiple letters of undertakings worth Rs.11,400 crores from Punjab National Bank.
- Year of Fraud Reporting: 2018
- Fraud amount: Rs.14,000 crores
- Modus Operandi: He was sanctioned with multiple fraudulent letter of undertakings over six years and a few bank officials colluded with the customer to arrange the same.
- Causes:
 - a) Lapse in effective internal control in banks includes poor audit/inspection practices and failure to adhere to vigilance department guidelines.
 - b) Lack of technology to detect fraud.
 - c) Huge sector concentration in the bank's advances portfolio (especially single bank branch).
- Perpetrators: Customer (Nirav Modi) & Bank Officials

3. Winsome Diamond Fraud

- Background: Winsome Diamond firm was owned by Jatin Mehta and his firm had obtained loans from various banks including multiple letter of credit for his business. However, he has suffered huge losses in commodity trading and ultimately it leads to failure in repaying loans.
- Year of Fraud Reporting: 2016
- Fraud amount: Rs.6,500 crores
- Modus Operandi: Huge funds diversion takes place in the bank's lending amount as he has diverted nearly 80% of the sanctioned amount to other personal uses by raising fake invoices.
- Causes:
 - a) Lack of effective post-sanctioning monitoring
 - b) Huge sector concentration in the bank's advances portfolio

- Perpetrators: Customer (Mehta J)

4. ABG Shipyard Fraud

- Background: The said firm was one of the largest shipbuilding centers and operating since 2005. The said firm had obtained loans from 28 various banks and the firm has failed to repay the debt since 2013. The said firm repeatedly obtained loans by using its greater market presence.
- Year of Fraud reporting: 2020
- Fraud amount: Rs.22,842 crores
- Modus Operandi: Huge funds diversion takes place in the said account and the same was revealed in a forensic audit
- Causes:
 - a) Lack of effective post-sanctioning monitoring.
 - b) Lapse in effective internal control in banks includes improper appraisal and monitoring.
 - c) Huge sector concentration in the bank's advances portfolio
- Perpetrators: Customer (R Agarwal)

5. Sterling Biotech Fraud

- Background: The firm is into pharma manufacturing and is located in Gujarat, India. The firm had availed loans from various banks out of which erstwhile Andhra Bank is the largest lender
- Year of Fraud Reporting: 2017
- Fraud amount: Rs.16,000 crores
- Modus Operandi: Huge siphoning of funds was observed in the said account and it was revealed that the loan proceeds were utilized for running their oil business by establishing many shell companies
- Causes:
 - a) Lack of effective post-sanctioning monitoring.
 - b) Lapse in effective internal control in banks includes improper appraisal and monitoring.
- Perpetrators: Customer (Nitish & Chetan Sandesara)

6. Kanishk Gold Bank Fraud

- Background: The firm's main business was jewellery manufacturer and this firm supplies its products to retail outlets. The firm has availed loans with 14 multiple banks since 2008. Subsequently, the account becomes NPA due to nonrepayment. At the time of the valuation of assets, after the account became NPA, it was only one-fifth of the value to the original value.
- Year of Fraud Reporting: 2017
- Fraud amount: Rs.825 crores
- Modus Operandi: Funds diversion was observed in the account and the firm obtained multiple limits by producing bogus financial statements.
- Causes:
 - a) Lack of effective post-sanctioning monitoring.
 - b) Lapse in effective internal control in banks includes improper appraisal and monitoring.
 - c) Lack of proper internal audit.
- Perpetrators: Customer (Bhoopesh Jain & Neeta Jain)

7. Rotomac Pen Scam

- Background: The firm was in the pen manufacturing business and sanctioned with multiple loans from various banks for its functioning, however, the account was declared as a Non-performing asset in the year 2015.
- Year of Fraud Reporting: 2015
- Fraud amount: Rs.3,695 crores
- Modus Operandi: Funds diversion was observed during the time of investigation as the firm was sanctioned with packing credit, however, exports were not made for the same.
- Causes:
 - a) Lack of effective post-sanctioning monitoring.
 - b) Lapse in effective internal control in banks includes improper appraisal and monitoring.
- Perpetrators: Customer (Vikram Kothari)

8. Videocon Case

- Background: The then-reputed brand Videocon firm was sanctioned with a Rs.3,250 crore loan by ICICI bank when Chanda Kochhar was MD & CEO. Subsequently, the account became a Non-performing asset.

- Year of Fraud Reporting: 2019
- Fraud amount: Rs.3,250 crores
- Modus Operandi: An amount of Rs.65 crore (approximately) received by a company owned by the husband of Chanda Kochhar from Videocon upon sanctioning the loan. It indicated that undue advantage is observed in the said case.
- Causes:
 - a) Lack of effective post-sanctioning monitoring.
 - b) Lapse in effective internal control in banks includes improper appraisal and monitoring.
 - c) Lack of Ethical conduct among the staff
- Perpetrators: Bank staff & customer (Chanda Kochhar ex- MD& CEO of ICICI bank and Venugopal)

As per Table -1, it is depicted that maximum officials in public sector banks (from different scales) mentioned that business pressures cause more bank frauds and almost a similar score was given to “for meeting business targets” which leads to fraudulent cases due to abnormal lending. The next reason stated as irregular lending due to the integrity issue of employees i.e. corruption involvement. As per table-2, it is depicted that maximum officials in private sector banks (from different scales) mentioned that business pressures cause more bank frauds and a similar score was given to “for meeting business targets” and corruption involvement of insiders i.e. bank employees.

Table -1: Rating given by public sector bank employees pertains to the reasons for corporate fraud in Banks.

Reasons for Frauds in Public Sector Banks (for maximum 10-point rating)					
Rank	Lack of awareness of bank guidelines	Overburden due to inadequate staff	Business pressures	To meet Targets	corrupted higher officials
Scale IV	3	5	9	7	7
Scale III	3	5	9	7	7
Scale II	3	6	9	9	8
Scale I	4	7	8	9	9

Source: Author’s compilation

Table -2: Rating given by private sector bank employees pertains to the reasons for corporate fraud in Banks.

Reasons for Frauds in Private Sector Banks (for maximum 10-point rating)					
Rank	Lack of awareness of bank guidelines	Overburden due to inadequate staff	Business pressures	To meet Targets	corrupted higher officials
Scale IV	3	2	8	8	7
Scale III	3	3	8	8	8
Scale II	3	3	9	8	8
Scale I	4	3	9	7	8

Source: Author’s compilation

Conclusion:

The current study provides deep insights into the overview of top fraudulent cases by corporates and their impact on the Banking sector. Indian banks have lost Rs.75,912 crores in the top eight banking frauds reported to date. Our study revealed business pressures which include internal and external like political pressures, top management pressures, and promotion greed lead to deviation in guidelines in credit sanctioning and also with the involvement of insiders i.e. corrupted bank employees cause fraudulent activities in bank transactions. Banks should focus on effective post-sanction monitoring of advances, particularly in the disbursement of loan proceeds by engaging data analytics tools as it was revealed that the modus operandi of most of the corporate frauds is siphoning of funds. Our policymakers must review the existing fraud risk management policy of banks and adopt efficient tools for post-sanction monitoring of banks' advances to curtail fund diversion. Also, our government should implement a fast trail against corporate fraudsters to avoid further loss. This study will pave new avenues for upcoming researchers to investigate existing legal proceedings and current technology adoption in preventing corporate fraud in the Indian Banking sector.

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