

Impact of Frauds on the Indian Banking Sector

Ainsley Granville Andre Jorge Bernard, Brahma Edwin Barreto, Rodney D'Silva

Abstract: Banks act as engines that steer the processes of money markets, the financial sector and economic growth. The Indian banking sector has expanded at a fast pace, especially as we stand today on the brink of the fourth industrial revolution. However, this has not come without its due share of complications. Along with the swiftly growing banking industry, frauds in Indian banks have seen an rising trend and there is an urgent need to revamp the banking sector in India, given the scams involving crores of rupees being unearthed in the recent past. The present study makes an attempt to review and analyse the trend of frauds plaguing the banking sector and its role in the continuous rise of Non- Performing Assets in the India. Further the study endeavours to throw light on the impact of rising bank frauds on profitability of the banking sector in India. The study concludes that the number of frauds plaguing the Indian banking sector is on a constant rise in recent years leading to a rise in NPAs and severely impacting profitability of the banking sector in India. Stringent action by authorities along with finding new means of fraud prevention and reduction is the only way forward for safeguarding the credibility of Indian banks and giving a face-lift to the banking sector of the country.

Keywords: Frauds, Non-Performing Assets, Profitability, Banking Sector

I. INTRODUCTION

The resilience of a growing economy is determined when its banking system is put to test. India, with its immense growth potential, has stayed relatively stable throughout a series of global recessions and has emerged reasonably unscathed. It is ironic however, that a steadfast system such as this, would contain a series of vulnerabilities which have been left unaddressed; increasingly becoming gaping black holes and tarnishing the image of the banking sector. The most evident of the issues faced by the sector and also its primal risk factor is the resultant impact of frauds. Frauds continue to be one of the major problems in the banking and financial services domain and the rapid growth of fraudulent activity is a testament to how difficult fraud is to detect and prevent — a fact that criminals take advantage of. The health of a nation's financial and banking system facilitates in determining its production and consumption patterns of goods and services. It acts as a direct gauge of the standard of living and well-being of its citizens.

Revised Manuscript Received on May 28, 2019.

Ainsley Granville Andre Jorge Bernard, Assistant Professor, Department of Commerce & Management, V.V.M's Shree Damodar College of Commerce and Economics, Margao - Goa, India

Brahma Edwin Barreto, Associate Professor, Department of Commerce & Management, V.V.M's Shree Damodar College of Commerce and Economics, Margao - Goa, India

Rodney D'Silva, Associate Professor, Department of Commerce & Management, V.V.M's Shree Damodar College of Commerce and Economics, Margao - Goa, India

Thus, if the banking structure is afflicted with soaring levels of frauds and consequently increasing NPAs, then it becomes a source of worry, since it mirrors financial anguish of borrowers and clients, as well as inefficiencies in transmission mechanisms.

In recent years, instances of banking fraud reported in India are on a steady rise. Even though in India, banking frauds have frequently been treated as one of the costs of transacting business, after liberalisation their frequency, complexity and inherent costs of frauds have swelled manifold resulting in a very grave cause of alarm for regulators due to its harsh impact on the banks profitability and consequently on the Indian economy.

II. LITERATURE REVIEW

P.K. Gupta and Sanjeev Gupta (2015) identified that the regulatory system is very weak and there is a dire need of redefining the role of auditors in today's globalised business environment. This study assumes that fraud could be mitigated by proactive and conscious action by auditors and corporate executives who are willing to avoid perpetrating financial fraud despite pressures from investors, government securities regulators and exogenous market fluctuations. The research also made a structured attempt to investigate into the role of fraud perpetrators, quantum of frauds and the modus operandi behind frauds.

Douglas E. Ziegenfuss (1995) made an attempt to lay emphasis on local and state government fraud survey. The research made use of questionnaire method wherein local government auditors were interviewed to determine the amount of fraud in state and local governments. The study concludes that fraud is a significant problem for state and local governments and finds that management is not responding effectively to the actual frauds when they are discovered; most of the loss in fraud cases is accounted for by misappropriation of funds, other false representation, other fraud, or false invoices.

Soni R. R. and Soni Neena (2013) made an attempt to investigate into cyber frauds plaguing the private as well as public sector banks. The study aimed to introduce the concept of cyber frauds in banking sector and make meaningful analysis on the same. Data from RBI website was used to support the study. The study concluded that private sector banks and foreign banks have a significantly higher number of cyber frauds as compared to public sector banks. It also showed that though there has been a considerable decline in the number of bank cyber frauds the value of such frauds has not come down proportionately.



III. OBJECTIVES

1. To review and analyse the trend of frauds plaguing the banking sector in India.
2. To examine the impact of frauds in the continuous rise of NPAs in the Indian banking sector.
3. To elucidate the impact of rising bank frauds on profitability of the banking sector in India.

IV. HYPOTHESIS

1. Impact of frauds on rising Non Performing Assets in the Indian banking sector.

Ho: Frauds do not have a significant impact on Non Performing Assets in the Indian banking sector.

H1: Frauds have a significant impact on Non Performing Assets in the Indian banking sector.

2. Impact of frauds on profitability of the Indian banking sector.

H0: Frauds do not have a significant impact on profitability of the Indian banking sector.

H1: Frauds have a significant impact on profitability of the Indian banking sector.

V. RESEARCH METHODOLOGY

The present study is based entirely on secondary data. Data from RBI website, annual reports, government reports, academic journals, archived RBI speeches and newspapers were obtained for the purpose of this study. Financial Stability Reports of RBI over the years have also been analysed to understand the past as well current scenario of the banking sector in India and the various problems that plague this sector.

VI. DATA ANALYSIS

Table. 1 Frauds in Indian Banking Industry

Financial year	Frauds of ₹1 lakh and above (A)				Out of A, Credit related frauds (B)			
	No. of frauds	Percentage Increase	Amount involved (in billions)	Percentage increase	No. of frauds	Percentage increase	Amount involved (in billions)	Percentage increase
2013-14	4306	-	101.708	-	1990	-	84.121	-
2014-15	4639	1.16	194.551	-3.89	2251	-5.60	171.222	1.44
2015-16	4693	8.16	186.988	28.00	2125	9.27	173.681	18.39
2016-17	5076	16.57	239.339	72.01	2322	8.79	205.614	9.72
2017-18	5917	7.73	411.677	91.28	2526	13.12	225.590	103.54

Source: RBI Financial Stability Report 2018

Table 1 outlines the number of frauds as well as their corresponding value over the five year period beginning in 2013-14 upto 2017-18. A classification of credit related frauds is also depicted. It is exceedingly clear that the amount involved in frauds has risen drastically in comparison to the increase in number of frauds. Majority of the frauds plaguing the Indian banking sector tend to stem from granting of credit by banks.

public sector banks. It is very much evident that majority of frauds in the banking sector relate to advances which is a cause of worry for banks in India.

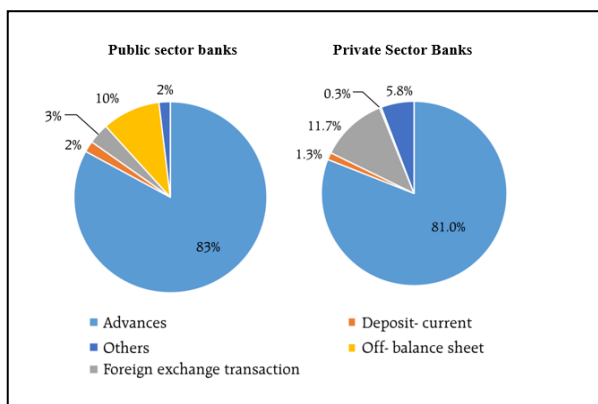


Fig. 1 Frauds from various sources reported in banks

Source: RBI Financial Stability Report 2018

Figure 1 makes an attempt to showcase frauds from various sources as reported by private sector as well as

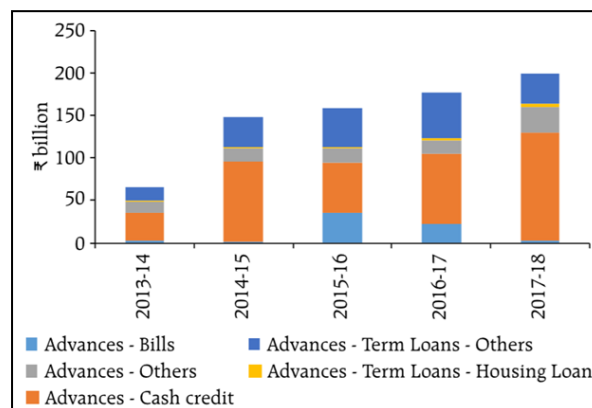


Fig. 2 Advances Related Frauds in Public Sector Banks

Source: RBI Financial Stability Report 2018

Figure 2 further classifies frauds related to advances in Public Sector Banks with respect to bills discounted, cash credit, term loans, housing loans and other advances. It is evident that majority of frauds related to advances in Public Sector Banks arise from cash credit extended by banks to businesses.



Table. 2 Gross Non Performing Assets and Gross Advances

Year	Gross NPA (₹ in Billions)	Gross Advances (₹ in Billions)	Gross NPAs to Gross Advances Ratio (%)
2013-2014	2630.152	68757.479	3.83
2014-2015	3229.161	75606.658	4.27
2015-2016	6116.074	81711.142	7.48
2016-2017	7902.680	84767.053	9.32
2017-2018	10361.872	92662.096	11.18

Source: www.rbi.org.in

Table 2 provides a comparative analysis of Gross NPA and Advances. It is evident that Gross NPAs have risen steadily over the years along with a corresponding growth in deposits. The Gross NPAs to Gross Advances Ratio although not very alarming, has shown a rising trend over the years.

Table. 3 Impact of frauds on rising Non Performing Assets in the Indian banking sector

Regression Statistics	
R Square	0.814608797
Coefficients	25.40465104
P-value	0.035975699

Source: Authors Compilation

For the purpose of regression analysis, amount involved in frauds is considered as independent variable and Gross NPAs are considered as dependent variable. R Square is 0.8146 which implies that 81.46% variations in Non Performing Assets are explained by frauds. It is found that frauds have a significant impact on Non Performing Assets at 5 percent level of significance. Coefficient Value is positive indicating that increase in frauds will lead to a corresponding rise in NPAs. We therefore reject the null hypothesis and conclude that frauds have a significant

impact on Non Performing Assets in the Indian banking sector.

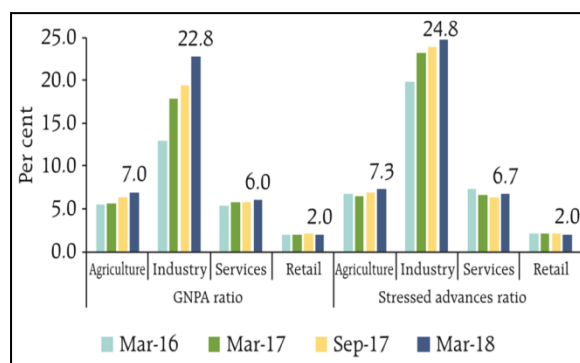


Fig. 3 Asset Quality of Broad sectors

Source: RBI Financial Stability Report 2018

Figure 3 depicts the Asset Quality of broad sectors of the economy. Gross NPA Ratio and Stressed Advances Ratio are considered as indicators of asset quality within the banking sector. It is clearly seen that asset quality of industry related advances followed by advances related to the service sector are a matter of concern for the banking sector in India.

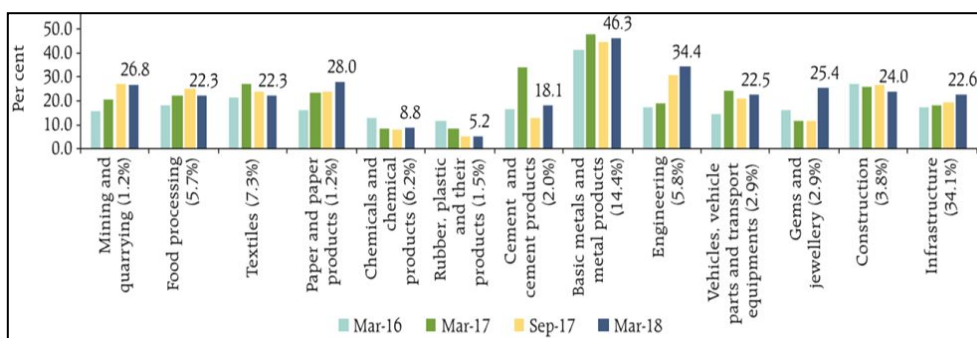


Fig. 4 Stressed Advance Ratio of Major Sub Sectors within Industry

Source: RBI Financial Stability Report 2018

Figure 4 makes an attempt to further classify the Asset Quality of sub-sectors within the industrial sector. It is evident that stressed advanced ratio of Basic metals and metal products followed by engineering industry have the highest stressed advances ratios. Most of the other sub-sectors within the industrial sector have a stressed advance ratio ranging between 5 percent to 25 percent of the total loans advanced.

Table. 4 Profitability of All Scheduled Banks

Financial Year	Net Profit (₹ in Billion)
2013-14	809.127
2014-15	890.778
2015-16	341.482
2016-17	438.995
2017-18	-324.377

Source: www.rbi.org.in



Impact of Frauds on the Indian Banking Sector

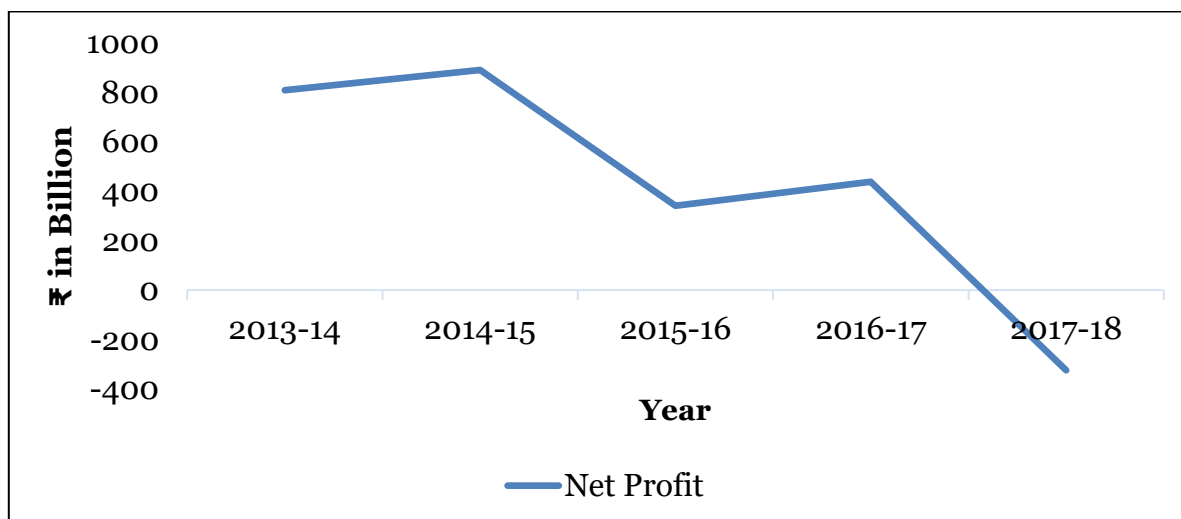


Fig. 5 Profitability of All Scheduled Banks

Source: RBI Financial Stability Report 2018

Table 4 and Figure 5 indicate the trend of profitability in the banking sector in India. It is seen that profitability of banks is on a steady decline which needs to be an eye opener as it poses a threat to the economy.

Table. 5 Impact of frauds on profitability of the Indian banking sector

Regression Statistics	
R Square	0.799592051
Coefficients	-3.765764033
P-value	0.040649263

Source: Authors Compilation

For the purpose of regression analysis, amount involved in frauds is considered as independent variable and profitability is considered as dependent variable. R Square is 0.7995 which implies that 79.95% variations in profitability are explained by frauds. It is found that frauds have a significant impact on profitability at 5 percent level of significance. Coefficient Value is negative indicating that increase in frauds will lead to a corresponding decrease in profitability. We therefore reject the null hypothesis and conclude that frauds have a significant impact on profitability of the Indian banking sector.

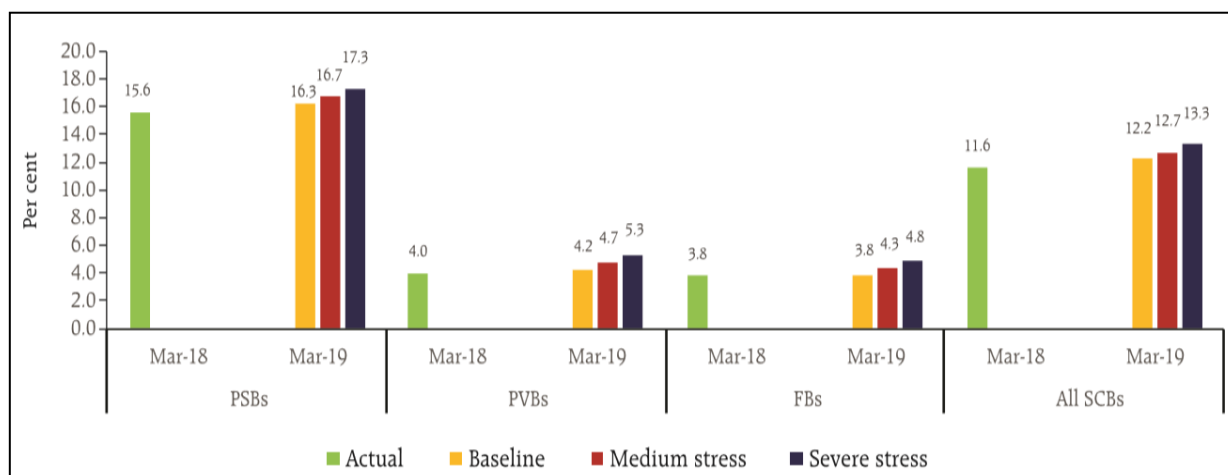


Fig. 6 Projections of SCB's GNPA ratios

Source: RBI Financial Stability Report 2018

Figure 6 makes a comparative analysis of Gross NPAs for the year ended March 2018 and projected NPAs for the year ended March 2019. The projection of system level GNPA for the year 2018-19 has been done using three different, but complementary econometric models multivariate regression, vector autoregressive and quantile regression which can deal with tail risks and takes into account the non-linear impact of macro-economic shocks. A rise in the

projected NPAs is witnessed over the current levels of the year ended March 2018.



VII. FINDINGS AND CONCLUSION

It is evident that post liberalization era has showered new colours of growth upon the Indian banking sector but simultaneously it has also posed some serious challenges; one of them being rise in frauds and NPAs. This unhealthy development of rising fraudulent activities afflicting the banking sector generates not only losses for the banks involved but also impinges their credibility adversely. Frauds and fraudulent activities wreak severe financial dilemmas on banks and their clients, as well as cause a significant reduction in the quantum of money accessible for economic development. While it may not be probable for banks to conduct their operations in a zero fraud milieu, proactive measures, such as conduct of risk assessment of policies and procedures can aid banks to circumvent their risk of contingent losses resulting from frauds. The data analysis technology can be leveraged by banks to detect frauds at the incipient stage itself and reduce their loss causing impact significantly.

In recent years, instances of banking fraud reported in India are on a steady rise. Even though in India, banking frauds have frequently been treated as one of the costs of transacting business, after liberalisation their frequency, complexity and inherent costs of frauds have swelled manifold resulting in a very grave cause of alarm for regulators, due to its harsh impact on the banks' profitability and consequently on the Indian economy.

The delays in legal procedures for reporting, and various loopholes in the system have been considered some of the major reasons of frauds. The growth in number of frauds over the years is marginal whereas the growth in value of frauds has shown tremendous increase indicating that frauds involving larger amounts have been happening in recent years. Growth of advances supported by a corresponding rise in the number of frauds and Non-Performing Assets has severely affected the profitability of the banking sector in India. Stringent action by authorities along with finding new means of fraud prevention and reduction is the only way forward to safeguard the credibility of Indian banks and give a face-lift to the banking sector of the country.

The following conclusions can be drawn from the study:

- The amount involved in frauds has risen drastically in comparison to the increase in number of frauds.
- Majority of frauds in the banking sector relate to advances which is a cause of worry for banks in India.
- The Gross NPAs to Gross Advances Ratio has shown a rising trend over the years.
- Asset quality of industry related advances followed by advances related to the service sector are a matter of concern for the banking sector in India.
- Frauds have a significant impact on Non-Performing Assets in the Indian banking sector.
- Profitability of banks is on a steady decline which needs to be an eye opener as it poses a threat to the economy.
- Frauds have a significant impact on profitability of the Indian banking sector.

REFERENCES

1. Bhasin, M. L. (2012), "Audit Committee Scenario and Trends in a Developing Country", School of Doctoral Studies European Union Journal, Vol. 4, pp. 53-70.
2. Bhasin, M. L. (2013), "Corporate Governance and Forensic Accountant: An Exploratory Study", Journal of Accounting, Business and Management, October, Vol. 20(2), pp. 55-75.
3. Bhasin, M. L. (2015), "Menace of Frauds in the Indian Banking Industry: An Empirical Study", Australian Journal of Business and Management Research, Vol. 4(2), pp. 21-33.
4. Calderon, T. and Green, B.P. (1994), "Internal Fraud Leaves Its Mark: Here's How to Spot, Trace and Prevent It", National Public Accountant, Vol. 39(2), pp. 17-20.
5. Chiezey, U. and Onu, A.J.C. (2013), "Impact of Fraud and Fraudulent Practices on the Performance of Banks in Nigeria", British Journal of Arts and Social Sciences, Vol. 15(1), pp. 12-25.
6. Deloitte Survey (2012). Indian Banking Fraud Survey, Business Standard, February 8.
7. Ganesh, A. and Raghurama, A. (2008), "Status of Training Evaluation in Commercial Bank", Journal of Social Sciences and Management Sciences, Vol. 37(2), pp.137-58.
8. Gupta, P. K and Gupta, S. (2015) "Corporate Frauds in India- Perceptions and Emerging Issues", Journal of Financial Crime, Vol. 22 (1), pp. 79-103.
9. Khanna, A. and Arora, B. (2009), "A Study to Investigate the Reasons for Bank Frauds in Indian Banking Industry", Int. Journal of Business Science and Applied Management, Vol. 4 (3), pp. 1-21.
10. Pan, S. (2015), "An Overview of Indian Banking Industry", International Journal of Management and Social Science Research, Vol. 4 (5), pp. 67-71.
11. Siddique, M.I. and Rehman, S. (2011), "Impact of Electronic Crime in Indian Banking Sector: An overview", International Journal of Business and Information Technology, Vol. 1(2), pp. 159-164.
12. Soni, R.R and Soni, N. (2013), "An Investigative Study of Banking Cyber Frauds with Special Reference to Private and Public Sector Banks", Research Journal of Management, Sciences, Vol. 2(7), pp. 22-27.
13. Zeigenfuss, D.E. (1996), "State and Local Government Fraud Survey for 1995". Managerial Auditing Journal, Vol. 9, pp. 49.